Dayton Hudson Corporation

Annual Report 1985

Financial Highlights

	1985 52 Weeks Ended February 1, 1986	1984 53 Weeks Ended February 2, 1985	Percent Increase
For the Year:			
Revenues	**$8,793.4**	$8,009.0	10%
Earnings before income taxes	**524.6**	479.3	9
Income taxes	**241.0**	220.0	10
Net earnings	**283.6**	259.3	9
Net earnings per share	**2.92**	2.68	9
Cash dividend paid per share	**.76**	.67¼	13

All dollars in millions, except per-share data.

At Year-End:			
Shares outstanding	**97,196,263**	96,991,626	
Number of shareholders	**15,022**	15,898	
Retail square feet	**45,882,000**	42,514,000	
Number of stores	**1,206**	1,136	

REVENUES (Billions of Dollars)

NET EARNINGS PER SHARE

*Continuing operations

CASH DIVIDEND PAID PER SHARE

SHAREHOLDERS' INVESTMENT PER SHARE

Dayton Hudson Corporation is a growth company focusing exclusively on retailing. At year-end, the Corporation was operating 1,206 stores in 48 states, the District of Columbia and Puerto Rico. ■ Dayton Hudson's principal operating strategy is to provide exceptional value to the American consumer through multiple retail formats. Retail operations are conducted by five companies, which are organized into four business segments:

Target 8

Target is an upscale discount store chain operating in 22 states. Target offers low prices on a broad assortment of high-quality fashion and basic hardlines and softgoods in easy-to-shop, self-service stores.

Dayton Hudson Department Store Company 12

The Dayton Hudson Department Store Company emphasizes fashion leadership, quality merchandise, broad selections and customer service. It operates Hudson's and Dayton's stores in seven states.

Mervyn's 10

Mervyn's is a highly promotional, popular-priced, value-oriented department store company operating in 10 states. Mervyn's stores feature nationally branded and private-label apparel, accessories and household softgoods.

Specialty Merchandisers 14

Specialty merchandising operations are conducted by two multi-store companies: B. Dalton Bookseller, a national bookstore chain, and Lechmere, a New England hardlines retailer.

Contents

ABOUT THE COVER:

As a strategic marketing company, we are driven by a strong focus on our customers. One way we respond to our customers' changing needs and wants is by being the first to offer the newest trends in merchandise.

On the cover and in the review of operations on pages 8-15, we present some of the major merchandise trends within each of our business segments.

To Our Shareholders:

We are very pleased to report that Dayton Hudson Corporation achieved record results for 1985. ■ The year marked the 15th consecutive annual improvement in earnings from retail operations. Net earnings were $283.6 million, an increase of 9% over net earnings of $259.3 million in 1984. Net earnings per share were $2.92, compared with $2.68 last year. ■ Revenues for the year were $8.8 billion, up 10% over $8.0 billion in 1984. Comparable-store revenues—revenues from stores open longer than 12 months—increased 6% over last year. (Fiscal 1985 consisted of 52 weeks, compared with 53 weeks in fiscal 1984.) ■ Dividends paid to shareholders in 1985 increased 13% to $.76 per share. ■ Operating profit was up 9% in 1985. Our three largest business segments—Target, Mervyn's and the Dayton Hudson Department Store Company—each reported double-digit operating profit increases over last year. (Operating profit is LIFO earnings from operations before corporate and interest expense, unusual expenses and income taxes.) ■ The record results achieved by Target and Mervyn's came at the same time that both companies continued their rapid expansion. Our department store operations gained strength throughout the year as we began to benefit from the 1984 combination of Dayton's and Hudson's. ■ Despite lower operating profit, our specialty merchandisers group also made progress in 1985 as B. Dalton strengthened its value offering and Lechmere continued to expand. ■ Although we did not meet our 15% earnings growth objective in 1985, we are nevertheless encouraged by the progress our operating companies made during the year.

Capital Investment and Expansion

Our total capital investment, including capital expenditures and the present value of operating leases, was $487 million in 1985. That compares with a capital investment of $397 million in 1984. ■ Total retail space at year-end increased to 45.9 million square feet from 42.5 million square feet a year ago. Total stores numbered 1,206 at the end of the year, up from 1,136 at the end of 1984. ■ During 1985, we added 11 Target stores, 22 Mervyn's stores, 36 specialty merchandising stores and one department store. ■ We also opened five RG. Branden's stores. RG. Branden's is a home furnishings test strategy operating in Miami and Jacksonville, Florida, and Atlanta, Georgia. ■ We anticipate a capital investment of more than $600 million in 1986. Scheduled to open during the year are 21 Target stores, 27 Mervyn's stores and approximately 70 specialty merchandising stores. We also will continue to test RG. Branden's. ■ Expansion plans for the 1986-1990 period call for a capital investment of approximately $4 billion.

Financial Position

We continue to maintain a strong capital structure. Our ratio of balance sheet debt to total capitalization increased slightly in 1985 as we borrowed to fund investment in future growth opportunities. ■ Internally generated funds are expected to provide the majority of our $4 billion investment in expansion during the 1986-1990 period. Borrowing will be added each year to additionally fund our capital investment plans. We project our ratio of debt to total capitalization to remain well within the range necessary to ensure a strong and conservative financial position.

Management and Board Changes

Kenneth A. Macke, Chairman and Chief Executive Officer, was named to the additional post of Chairman of the Executive Committee of the Board in 1985. He succeeds William A. Andres, who retired during the year. ■ Mr. Andres' retirement is the culmination of a 27-year career with Dayton Hudson Corporation. He joined Dayton's in 1958 and moved up through the company's merchandising ranks to become President and Chief Executive Officer in 1968. He was named President of Dayton Hudson Corporation in 1974. In 1976, he became Chief Executive Officer and was elected Chairman the following year. We are indebted to Mr. Andres for the leadership and guidance he provided throughout his career. His contributions to the growth and development of Dayton Hudson Corporation are deeply appreciated. In January 1986, Mr. Andres accepted the National Retail Merchants Association Gold Medal Award as 1986 "Retailer of the Year." The award recognizes his many contributions to the retail industry over the years, most recently his efforts on behalf of free trade. ■ P. Gerald Mills, former Chairman and Chief Executive Officer of the Dayton Hudson Department Store Company and Executive Vice President of Dayton Hudson Corporation, retired in 1985. We are grateful for the contributions he made to our department store operations. ■ Bruce G. Allbright, Chairman and Chief Executive Officer of Target, was named to the additional post of Senior

Vice President of Dayton Hudson in 1985. Mr. Allbright joined the Corporation in 1971. ■ John A. Rollwagen, Chairman and Chief Executive Officer of Cray Research, Inc., was elected to the Board of Directors in January 1986. Mr. Rollwagen's election increases the size of the Board to 12 members. He is one of nine outside directors. ■ E. Peter Gillette, a director since 1983, resigned from the Board in 1985 in conformance with Board policies regarding change in principal employment. We appreciate his service to the Corporation.

The Outlook

As we enter 1986, many of the fundamental elements for continued growth in consumer spending are in place. Consumer confidence is high, reflecting increases in disposable income and personal net worth as a result of higher employment levels and recent stock market gains. Interest rates have fallen and inflation appears to be under control. At the same time, however, there is some evidence that high levels of installment debt are causing consumers to slow down their spending, particularly credit purchases. ■ Our outlook for 1986 calls for moderate growth in consumer spending and a highly competitive retail environment. We will continue to keep a close watch on inventory levels, margins and expenses as the year unfolds. ■ Looking to the longer term, we remain optimistic about our prospects. While the retail environment will remain highly competitive, we believe we have strategies that offer our customers a clear reason to choose our stores. We are confident that our strategies will provide us with the focus and direction necessary to continue to perform as a premier growth company. ■ Our strategies are only as good as the people who implement them. We are indeed fortunate to have a very strong base of people throughout our entire Corporation. We consider each of our 128,000 employees as a partner in our commitment to growth.

Kenneth A. Macke

Kenneth A. Macke
Chairman of the Board
and Chief Executive Officer

Boake A. Sells

Boake A. Sells
President

April 2, 1986

Left to right:
Kenneth A. Macke,
Chairman of the Board and Chief Executive Officer

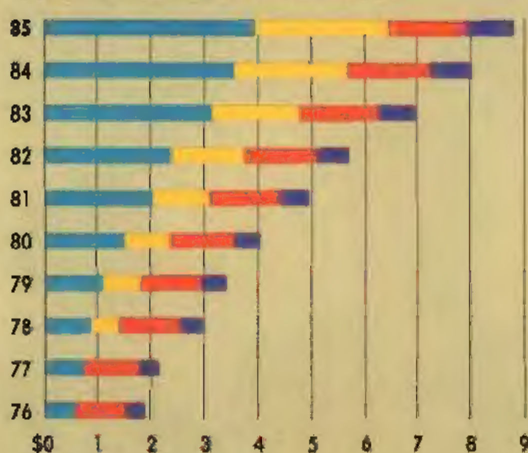
Boake A. Sells,
President

Gerald R. Gallagher,
Vice Chairman and Chief Administrative Officer

Throughout our nearly 20 years as a public company, we have had one principal objective: to be a premier growth company. ■ Today, our commitment to growth is stronger than ever. It is reflected throughout our entire organization—in our management philosophy, in our financial objectives, in our plans for the future and, perhaps most important, in the drive and determination of our people. ■ Our record stands as a testimony to the strength of our commitment. Over the past 10 years, our revenues have increased at a compound annual rate of 17%. Retail earnings have also risen at an annual rate of 17%. Total stores have grown from 350 to over 1,200. ■ Our business has also evolved as we have shifted strategic direction in response to changes in our environment. Ten years ago, department store operations accounted for the majority of our business. In contrast, today almost three-fourths of our revenues are derived from Target and Mervyn's, our two major growth strategies. We have also grown from a regional company based in the Midwest to a national retailer with a strong presence in many of the fastest growing areas of the country. ■ Our plans for the 1986-1990 period reflect both our ongoing commitment to growth and the continuing evolution of our business. We currently plan a capital investment of approximately $4 billion over the five-year period. The majority of that amount will go to Target and Mervyn's as they strengthen their position in current markets and expand into new markets and geographic territories. ■ We are excited about our prospects for further growth. Today, Target operates in only 22 states while Mervyn's has stores in just 10 states. We have a lot of room to grow. We are confident that we can continue to increase our share of the total general merchandise retail business, which today stands at just 2.5%.

TEN YEARS OF GROWTH AND CHANGE

Revenues by Business Segment (Billions of Dollars)



Contributions to Revenues by Business Segment

As our business has grown, so has our strategic direction shifted in response to change.

- Target
- Mervyn's
- Department Stores
- Specialty Merchandisers

The Retail Outlook: A Time of Opportunity.

Our growth in the coming years will take place within an environment of tremendous opportunity for the retail business. ■ Consumer demographic trends are clearly in our favor. One-third of the nation's population—the Baby Boom generation—is moving into its peak earning and spending years. As this large and affluent group grows older, it will become an increasingly powerful force driving consumer spending. Another large segment of our population is made up of people over 55, most of whom have a significant amount of discretionary income. ■ We are also seeing a continuing rise in the number of two-income families as more women enter the workforce. New household formations continue to increase, creating demand for home-related merchandise. ■ Rapidly advancing technology is resulting in the introduction of new and affordable products. At the same time, technological advances continue to bring about improvements in our productivity by helping us manage our business more efficiently. ■ Our environment is also changing rapidly. Perhaps nowhere is that change more evident than in consumer attitudes and preferences. ■ With more shopping alternatives to choose from, customers today are less loyal and more demanding than in the past. They are also altering their shopping habits and expectations as their lifestyles change. ■ The nature of the retail marketplace is changing as well. While it offers customers today more stores to shop in and more merchandise to buy, there is an increasing similarity in the offering. As a result, retailing is becoming even more competitive. ■ As we plan for continued growth within this environment, it is evident that our most important challenge is to give our customers a compelling reason to shop in *our* stores. We must also remain intensely aware of competitive developments in the retail marketplace. And we must continue to be aware of change and manage it to our advantage.

A SHIFTING U.S. POPULATION
(Millions)

The fastest growth in our population will occur among 35-54 year olds—those entering their peak earning and spending years.

Strategic Marketing: A Tool for Managing Our Growth.

We believe we can respond most effectively to both the opportunities and the challenges in our environment with the help of a management tool we call strategic marketing. ■ Strategic marketing is an approach to retail planning and execution that is driven by a strong focus on our customers, their changing needs and the changing and competitive nature of the retail market-

place. It is a long-range plan of action that focuses our attention not just on the next season or the next year, but rather on five and even 10 years out. ■ Strategic marketing puts us in touch with our customers in several ways. By looking at changing demographics and social values, we form a picture of the customer of tomorrow. By listening carefully to focus groups and using surveys and other methods of formal research, we determine the needs and wants of today's customers. Target, for example, surveyed its customers to see how it could improve its stores. They said they wanted better access to merchandise, broader assortments in important categories and more informative signs. Target's new store design includes all these features—as well as many others that customers requested. ■ Strategic marketing also focuses us on the rapidly changing and increasingly competitive retail marketplace by directing us toward opportunities for long-term market share growth. ■ We recognize that we must continue to increase our share of market if we are to grow. We intend to do this in several ways. We will add stores in new markets and in markets where we already operate. We will take advantage of opportunities for additional business in our current stores. And we will continue to look for new strategies that have the potential to become tomorrow's growth companies. ■ In any case, our success depends upon our ability to maintain a unique and compelling competitive advantage. We believe we do have an edge on our competition. It lies in a strong, clearly focused merchandising identity. Our customers know exactly what they can expect to find in our stores. Because we are trend merchants, they can look to us for the newest merchandise. They can shop in stores that are designed with their needs in mind. And they can expect high levels of service. ■ We intend to maintain—and strengthen—our competitive edge by intensifying our search for new and innovative ways to serve our customers. ■ We will continue to look for unfulfilled customer needs and wants and respond with marketing innovations like B. Dalton's Software, etc. or Lechmere's new home office strategy. We will continue to provide high-quality, fashion-right merchandise—including exclusive private label products like those found in Target, Mervyn's, Dayton's and Hudson's. And we will continue to keep our stores fresh and responsive to

A GROWING MARKET SHARE

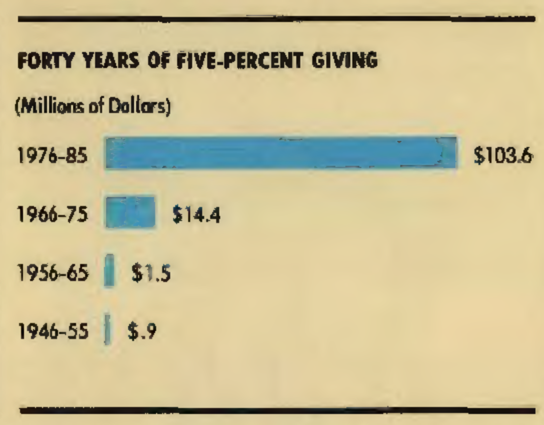
Revenues as Percentage of Total GAF Sales

Our share of total GAF (general merchandise, apparel and home furnishings) sales has doubled over the last 10 years.

changing customer needs, as in Target's new store design. ■ Our task is clear. We must serve our customers exceptionally well—better than the competition—if we intend to continue to meet our commitment to growth. We believe strategic marketing provides the direction and focus with which to do so.

Strategic Public Involvement: Keeping Our Communities Strong.

Just as we use strategic marketing to manage our growth, we use strategic public involvement to help us make a difference, long-term, to the health of our communities. ■ Forty years ago, in 1946, management made a formal commitment to budget an amount equal to 5% of our federally taxable income for worthwhile community programs. ■ Today that commitment is both strategic and comprehensive. We strive for leadership by focusing our giving in two major areas: social action programs and the arts. ■ Within those broad areas of focus, each operating company strategically targets its involvement to meet the needs of its primary customer segment in its communities. ■ Target and Mervyn's, for example, stress social action and arts programs to serve their primary customer group, families with young children. ■ B. Dalton's efforts are aimed at America's readers—both today's readers and the readers of tomorrow. Lechmere's focus is on youth, and the Dayton Hudson Department Store Company concentrates on programs for women and girls. ■ Our community involvement changes with the changing needs of our customers and their communities. We strive to address their emerging needs, as well as existing ones, and we hold ourselves accountable for achieving results. ■ We leverage our giving budget with the volunteer efforts of our people, and by forming partnerships with others in the community. We also take the initiative to help communities solve their problems, often becoming advocates on public issues that affect our customers. ■ Last year Dayton Hudson and its operating companies contributed more than $18 million through giving programs to make our communities better places to live, to work and to do business—and to make our customers more vital and self-sufficient. ■ We believe it is a strategy that makes good business sense because it provides a foundation for our growth.



Since 1946, we have given more than $120 million to help keep our communities strong.

Nicole Montgomery is a participant in Job Opportunity Partnership (JOP)—a work experience program for economically disadvantaged women and girls funded by the Dayton Hudson Department Store Company. JOP fosters self-sufficiency by providing job-readiness skills, mentor and peer support, and self-esteem building.

1985: An Excellent Year for Target

By all measures 1985 was an excellent year for Target. ■ Revenues increased 11% to climb near the $4 billion mark. Comparable-store revenues rose 6% over the previous year. Sales were particularly strong in the West Coast stores. ■ Operating profit was up 18% on the strength of improvements in the gross margin rate and the operating expense rate. The increase in the gross margin rate came even though Target continued to lower its everyday prices to provide greater value to its customers. ■ Target added 11 stores in 1985, including five in the Los Angeles area. Sales in the new stores were well above expectations.

Fashion, Demographics, Technology Drive Merchandise Trends

Fashion colors will be evident across all of Target's merchandise lines throughout 1986. ■ Fleecewear, sweaters and aerobic footwear are taking on brighter and bolder hues this year. Accessories, especially jewelry and fashion watches, are also brighter. ■ In hardlines, fashion colors are appearing on baseball gloves, bicycles, coolers and electronics. Items for the home are more colorful this year as well. ■ The Baby Boom generation's interest in fitness is resulting in strong growth in activewear such as fleece and athletic footwear. Sales of home office and electronics merchandise are growing steadily as this large segment of the population considers the home as both workplace and entertainment center. ■ Advances in technology are resulting in the introduction and affordability of many new products: multi-featured VCRs, compact disc players, personal computers, contact lens care items, electromechanical toys and rechargeable hardware products.

New Store Design Aims for Merchandising Impact

Target began testing a dramatic new store prototype in 1985 that is designed to provide customers with a more convenient and exciting en-

vironment in which to shop—and at the same time differentiate Target from its competition. ■ The prototype divides the store into three well-defined merchandise worlds—softlines, housewares/home decor and hardlines/leisure—which are separated by freestanding fixture walls. Within each world, the emphasis is on achieving greater merchandising impact through shallower departments, more product exposure on main aisles and expanded space for trend items. ■ At year-end 1985, the new design was featured in 13 Target stores. By the end of 1986, some 60 units will bear the look, including each of the 21 new stores set to open during the year.

Target Advertising Takes on a Bold New Look

Long the trendsetter in discount store advertising, Target is working even harder to set itself apart from the rest of the industry through innovative and creative promotion. ■ No longer simply a vehicle to advertise major sales events, Target's weekly newspaper circular has become a multi-purpose promotional tool. Advertised items include not only those that are promotionally priced for a sales event, but also those that feature everyday low prices. Trend items are also featured prominently in the circular. ■ Target's television advertising is taking on a more cre-

ative look as well. The 100 or so commercials produced in 1985 reached nearly 30% of all American households.

A Trend Merchandising Success Story

Target's commitment to being first with the newest trends often pays big dividends. Skateboards are a case in point. ■ Target began testing skateboards in 1984, when it spotted renewed interest in the product on the West Coast. A range of styles and sizes were tested in California stores as well as in other markets throughout the country. The results showed a growing national trend in oversized, multifeatured boards with colorful graphics. ■ Skateboards were available in all Target stores by early 1985 just as the trend began to explode. Today, Target holds a 10% share of the national skateboard market. ■ Bold new skateboard graphics designed exclusively for Target will provide a further competitive edge as the trend continues throughout 1986.

Twenty-One New Stores Planned for 1986

Target's expansion plans for 1986 call for 21 new stores. The additions will increase retail space by about 2 million square feet and bring total stores to 247 at year-end. ■ Among the planned openings are five additional stores in Los Angeles scheduled to begin operations in the fall. The expansion will increase total stores in the Los Angeles area to 30. ■ Also scheduled to open are three additional stores in Dallas and one additional unit in Houston. Two stores also will open in Phoenix, bringing total units there to eight. ■ The balance of the 1986 openings will be in markets in Wisconsin, Missouri, Minnesota, Indiana, Iowa and Montana.

C.A.R.E.—Customers Are Really Everything

Taking care of customers is Target's top priority—a job made easier by a new customer service program called C.A.R.E.—Customers Are Really Everything. ■ The C.A.R.E. program adds time-saving, customer convenience elements to the stores: redesigned service counters, store directories, automated teller machines, new signing and customer assistance phones. ■ Other features of the program are designed to instill a "customers come first" attitude throughout the entire Target organization. These include recognition for outstanding customer service and a "customer report card" which summarizes comments on service from weekly interviews with customers.

(Millions of Dollars)	1985	1984	1983
Revenues	$3,931.5	$3,550.1	$3,118.4
Operating Profit*	$ 277.8	$ 235.6	$ 176.8
Stores	226	215	205
Retail Square Feet (000)**	22,414	21,071	20,062

*Operating profit is LIFO earnings from operations before corporate and interest expense, unusual expenses and income taxes

**Total square feet less office, warehouse and vacant space

1985 OPERATING HIGHLIGHTS

- **Revenues increase 11% to $3.9 billion.**
- **Comparable-store revenues rise 6%.**
- **Operating profit up 18%.**
- **Gross margin, operating expense rates improved over last year.**
- **Eleven stores added; total stores rise to 226.**
- **Dramatic new store design unveiled.**

Record Performance, Continued Expansion Mark 1985

Mervyn's continued its string of record years in 1985, posting increases in both revenues and operating profit. At the same time it continued to expand rapidly. Twenty-two stores opened in 1985—the biggest single-year total in Mervyn's history. Among the new stores were units in three major new markets—San Antonio, Fort Worth and New Orleans. ■ Mervyn's revenues rose 18% in 1985. Revenues from comparable stores were up 8%. ■ Operating profit increased 10% over a year ago. The results were below expectations due to lower than anticipated sales in December, which resulted in a higher operating expense rate.

Atlanta Entry Highlights 1986 Expansion

Mervyn's expansion plans for 1986 call for 27 new stores. The expansion will bring total stores at year-end to about 175. Total retail space will increase by more than 2 million square feet during the year. ■ Mervyn's will enter the Atlanta market in 1986 with five stores — the first of eight units planned for the Atlanta area. ■ Three new stores in Tulsa will mark Mervyn's expansion into Oklahoma. In Colorado, Mervyn's will open stores in Denver, Boulder and Colorado Springs. ■ Other 1986 openings include additional stores in Texas, Louisiana, Washington, Oregon and California.

1985 OPERATING HIGHLIGHTS

- **Revenues up 18% to $2.5 billion.**
- **Comparable-store revenues up 8%.**
- **Operating profit up 10%.**
- **Gross margin rate approximately equal to last year; operating expense rate higher.**
- **Twenty-two new stores—the most in a single year.**

(Millions of Dollars)	1985	1984	1983
Revenues	$2,527.0	$2,141.1	$1,688.9
Operating Profit	$ 245.0	$ 223.3	$ 184.5
Stores	148	126	109
Retail Square Feet (000)	11,733	9,989	8,556

Apparel for Active Lifestyles Tops Trend List

Mervyn's customers are shopping for comfortable, casual, fitness-oriented apparel that suits their active lifestyles. ■ One of the season's strongest trends is knit dressing, a body-conscious look emphasizing slim and lean silhouettes. The trend features knit tops which are layered solid over solid or print over solid. ■ Exercise wear in updated colors, prints and patterns is also a key trend for 1986. Within this category, sales of aerobic footwear — especially Reebok shoes—should continue to increase dramatically throughout the year. ■ Fashion watches, a major accessories trend in 1985, will continue to be popular as new colors and styles are

introduced. ■ Customers are continuing to buy merchandise to help them become better organized. In housewares, bestselling organizers include bins and collapsible baskets and cartons.

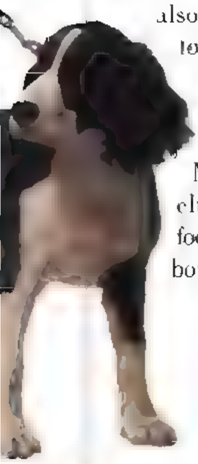
Mervyn's Is Positioned for Growth in Children's Wear

With the birth rate expected to remain at a high level in the coming years, Mervyn's is in a strong position to capitalize on continuing growth in sales of children's wear. ■ Children's apparel and related items account for about 20% of

Mervyn's sales. The offering consists of dominant assortments of national brands like Levi's, Health-tex, Carter's and Oshkosh, and Mervyn's own high-quality private label merchandise like Unicorn Club and Girl's Gear. ■ Mervyn's is the only retail company to be recognized consecutively by the Children's Wear Manufacturers Association as one of the country's outstanding children's wear retailers.

Customers Rate Mervyn's Private Labels High for Value

An extensive market research study conducted by Mervyn's in 1985 shows that customers give high marks to the company's private label merchandise—especially for its value. The study also shows that customers want fewer labels to pick from, but more selection in the brands that they believe represent the greatest value. ■ Private label merchandise accounts for about 60% of Mervyn's inventory. Popular labels include Cheetah activewear and athletic footwear, Cambridge Classics for men and boys and Celebration for the home.

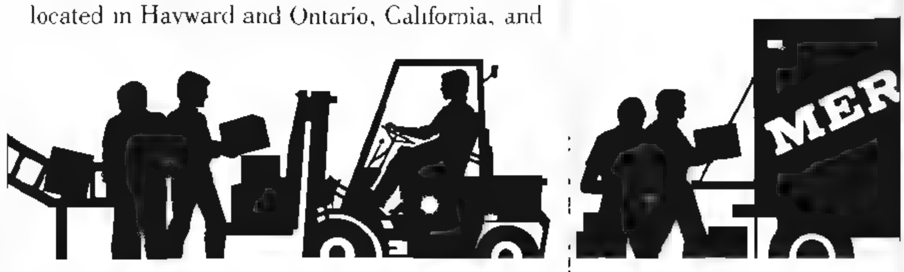


Direct Mail Catalogs Support the Weekly Tabloid

While Mervyn's highly successful advertising strategy is driven by its weekly newspaper tabloid, other promotional tools play key supporting roles in the total effort. Among these are direct mail catalogs. ■ Mervyn's tabloid, which has a weekly circulation of over 9 million copies, features promotionally priced items from every Mervyn's department. Direct mail catalogs support the tabloid by giving selected credit card customers advance notice of sales events and by spotlighting special values within selected departments. ■ The catalogs are targeted to specific customer groups based on analysis of past purchases by department. In 1985, some 30 catalogs were mailed, reaching over 13 million customers. ■ A new computer system installed in 1985 will improve Mervyn's ability to track department sales so that catalogs can be sent to more precisely targeted audiences in the future.

Fourth Distribution Center to Open in 1986

Mervyn's will open a 300,000-square-foot distribution center in Salt Lake City, Utah, in 1986, bringing to four the number of distribution facilities it operates. The new center will serve stores in the Northwest and Rocky Mountain states. ■ Mervyn's other distribution centers are located in Hayward and Ontario, California, and



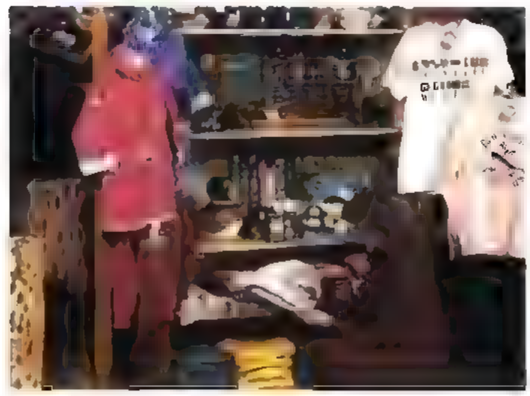
Plano, Texas. ■ Mervyn's distribution centers utilize state-of-the-art computer technology to ensure that stores maintain a consistent high in-stock position.

Improved Performance, Combination Progress Highlight 1985 for DHDSC

DHDSC revenues rose 4% in 1985. Operating profit was up 14%, following a decline a year ago. The results reflect both an improved gross margin rate and the comparison with weak 1984 performance. Operations gained strength steadily throughout the year, ending with a strong second half ■ Continued progress on the combination of Dayton's and Hudson's into a single organization was made in 1985, with major systems and personnel consolidation taking place during the year. The combination will be fully implemented by the end of 1986. ■ DHDSC opened one store in 1985, an 80,000 square foot Dayton's in Bismarck, North Dakota. Customer response to the new store has been exceptionally strong

Private Labels Fashion A Competitive Edge

DHDSC uses private label merchandise as a strategy to set itself apart from the competition. But rather than simply putting a store label on a single product, DHDSC takes the concept a step further by offering a variety of original products that reflect the lifestyles of its customers. ■ The concept began with the Boundary Waters label which initially appeared only on outerwear. Customer response to the merchandise was so strong that the label was expanded



to a diverse range of products. Today, the Boundary Waters label appears on over 200 items, including apparel, candy, soap, luggage and toys. ■ Other successful private label product lines include Marketplace housewares and cookware, Stork Club for infants and Woodward classic apparel for men and women. ■ DHDSC's private label lines expanded to nine with the introduction of two additional labels in 1985.

Spring Forecast Calls For New Colors, Shapes, Patterns

New colors, shapes and patterns dominate the fashion looks for spring at DHDSC. ■ The season's most popular colors include cool white, mint green and the "bleached blues"—cotton chambray and faded denim. ■ Career dressing is taking on a spare, uncluttered and sleek look, while dresses are closer to the body. ■ Patterns and prints are appearing everywhere, including denim, swimsuits, surfer shorts, casual anklet socks and boxy camp shirts. Popular motifs include fruits, dots, abstracts and palm trees. ■ Sweaters in textures such as boucle and cotton flake emerged as a major trend in 1985. Shaker knit sweaters were especially popular, with over

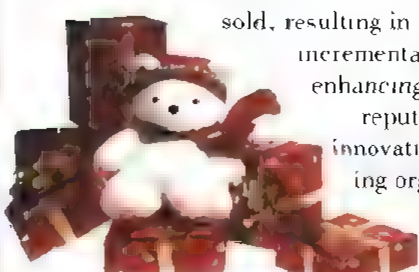
500,000 sold in Dayton's and Hudson's stores during the year. ■ Lean-styled five-pocket jeans in black and colored patterns for both men and women also were strong sellers in 1985.

Coming Out Ahead in Customer Service

"Tracking Toward Success," an employee training and recognition program implemented during 1985, is designed to help DHDSC meet one of its top priorities — improved customer service. ■ The new program helps sales consultants improve selling skills and provides recognition and rewards for outstanding customer service efforts. It focuses on customer contact, determining customer needs, highlighting product features and benefits, suggestion selling and inviting the customer to return. ■ DHDSC measures its progress in customer service with an annual performance audit which surveys over 5,000 customers on 15 different service factors.

Santabear: Innovative Marketing at DHDSC

Christmas 1985 got off to a fast start at DHDSC with the help of an innovative marketing tool called Santabear. ■ Manufactured exclusively for DHDSC, the plush white bear was offered at a retail price of $25. Beginning in early November, however, customers could buy the bear for $10 if they purchased at least $50 worth of merchandise in a single day at any Dayton's or Hudson's store. ■ Response to the promotion was overwhelming. By the time the supply of bears ran out, nearly a half million had been sold, resulting in substantial incremental sales and enhancing DHDSC's reputation as an innovative marketing organization.



Continued Growth Predicted for Cosmetics

Sales of cosmetics at Dayton's and Hudson's stores are increasing at a significantly faster rate than the industry, giving DHDSC good market share increases and a strong position in this highly profitable growth business. With continued growth predicted, DHDSC is giving more space and better positioning to this category as stores are remodeled. ■ Trends in fragrances reflect the customer's interest in newness and fashion with bestsellers including Giorgio and Obsession. Sales of men's fragrances are also growing dramatically. ■ In the treatment area, the trend is toward time-saving single products rather than the multi-product regimens that were popular in the past. ■ Surveys continue to show cosmetics ranking highest among all store departments in customer satisfaction.

New Advertising Concepts Support Stronger Trend Merchandising

DHDSC introduced two new concepts in department store advertising in 1985, both designed to support a stronger focus on trend merchandising. ■ *Today* magazine features color photography to present the latest trends and special values in apparel, home furnishings and electronics. Over 2.5 million copies of *Today* are distributed in 24 Sunday newspapers, reaching some 4 million customers. ■ Also bearing the name *Today* is a quarterly publication produced in a "magalog" format. The concept, which combines editorial and graphic elements from magazines and catalogs, includes national ads and is used to communicate the newest trends to both sales consultants and customers.

(Millions of Dollars)	1985	1984	1983
Revenues	$1,447.9	$1,396.3	$1,242.3
Operating Profit	$ 121.8	$ 106.7*	$ 155.7*
Stores	37	36	36
Retail Square Feet (000)	7,904	7,896	7,984

*Results from Diamond's and John A. Brown included through September 29, 1984.

1985 OPERATING HIGHLIGHTS

- Revenues increase 4% to $1.4 billion. Operating profit up 14%.
- Gross margin rate improved; operating expense approximately equal to last year.
- Operations gain strength during the year, ending with strong second half.
- Continued progress on the combination of Dayton's and Hudson's.
- Strong customer response to new Dayton's store in Bismarck, North Dakota.

1985 Results Reflect Lower Margins, Expansion Expenses

Revenues from specialty merchandising operations rose 15% in 1985. Comparable-store revenues were up 6%. B. Dalton's revenues increased 10%, while Lechmere's revenues were up 25%. ■ Operating profit declined 37% in 1985. The results reflect lower than anticipated sales combined with substantially lower gross margins at B. Dalton Bookseller, and expenses related to Lechmere's expansion in New England and Atlanta. ■ B. Dalton added 34 stores in 1985. The new units include B. Dalton bookstores, Pickwick discount bookstores and Software, etc. stores. Lechmere opened two stores during the year—one in Albany, New York, and one in Warwick, Rhode Island. ■ B. Dalton strengthened its value offering in 1985 with the introduction of an aggressive everyday promotional pricing program. The program features the top 10 hardcover bestsellers at discounts of 25% to 35% in every store throughout the chain.

Sales of Children's Books Continue to Increase

Sales of children's books continue to grow at B. Dalton as America's large Baby Boom generation begins to raise its own families. ■ Classic titles such as *The Velveteen Rabbit*, *Mother Goose* and the Dr. Seuss series are selling especially well. Other long-time favorites include the Berenstain Bears and several titles by Shel Silverstein. ■ Books for younger children—aged 2 to 6—are also popular with today's parents.

Software, etc. Opens First Stores

Software, etc., B. Dalton's entry into the fast-growing computer software market, opened four stores and added 27 units within existing B. Dalton stores in 1985. The expansion brings the strategy to customers in five new markets:

New York, Pittsburgh, San Francisco, Houston and Seattle. ■ B. Dalton began offering software in 1983. The assortments were expanded and remerchandised as a "store-within-a-store" concept the following year. ■ Software, etc. offers 2,000 software titles, 2,500 computer, business and technical books, and supplies and accessories for personal computers at everyday savings of 10% to 25%. Workstations within the stores allow customers to try out software titles on Apple, IBM and Commodore computers. ■ Twenty new Software, etc. stores will open in 1986, including a larger prototype to be tested in a selected market.

Strong Titles Top Bestseller Lists

B. Dalton's 1985 bestseller lists were topped by exceptionally strong titles in both the fiction and nonfiction categories. ■ The three bestselling fiction titles—*Texas* by James Michener, *Lake Wobegon Days* by Garrison Keillor, and *The Mammoth Hunters* by Jean Auel—each sold more than 175,000 copies

1985 OPERATING HIGHLIGHTS

- **Total revenues rise 15%; comparable-store revenues up 6%.**
- **B. Dalton's revenues increase 10%; Lechmere's revenues up 25%.**
- **Operating profit down 37%.**
- **B. Dalton adds 34 stores, including first Software, etc. units.**
- **Two new Lechmere stores opened.**

(Millions of Dollars)	1985	1984	1983
Revenues			
B. Dalton	$ 538.1*	$ 489.8	$ 445.1
Lechmere	348.9	280.2	227.0
Total	$ 887.0	$ 770.0	$ 672.1
Operating Profit	$ 37.0*	$ 58.8	$ 60.0
Stores			
B. Dalton	785	751	701
Lechmere	10	8	6
Total	795	759	707
Retail Square Feet (000)			
B. Dalton	2,677	2,587	2,446
Lechmere	1,154	971	790
Total	3,831	3,558	3,236

*Pickwick's results included

during the year. ■ America's search for heroes sparked a strong trend in autobiographies in 1985 with *Iacocca* by Lee Iacocca with William Novak and *Yeager* by Chuck Yeager and Leo Janos topping the nonfiction bestseller list. Both books are continuing to sell well in 1986.

Home Office Strategy Responds to Workplace Trends

The American workplace is changing. Computer technology is bringing the office into the home for many workers. At the same time, the shift to a service economy is bringing about an increase in the number of new businesses being formed. ■ Serving the increasing needs of both home office and small business customers is the objective of a new merchandising strategy which is being tested at Lechmere. ■ Located adjacent to the computer department, the strategy offers an expanded assortment of business and educational software, computer peripherals such as printers, monitors and modems, and computer furniture, including workstations, chairs and lamps. ■ Other office products include calculators, typewriters, copiers, mailing machines and computer paper. Multi-featured business phones and answering machines are located adjacent to Lechmere's telephone department.

Merchandise Trends: Electronics, Color, Quality

Lechmere's dominant position in leading-edge home electronics paid off in 1985 as sales in this fast-growing category rose steadily throughout the year. ■ Popular items included compact disc players and discs, multi-featured VCRs, pre-recorded videotapes and camcorders — video cameras that combine camera and recorder in one unit. ■ Color emerged as a major trend in many product categories, including portable stereos, audio speakers, phones, calculators, television and dinnerware. Better-quality merchandise like Cuisinart food processors, Henkels cutlery and Carver audio equipment also sold well. ■ Electronics sales are expected to continue to grow in 1986, sparked by stronger brand-name values and added features in such products as stereo rack systems, compact disc players and integrated audio/video systems. ■ During 1986, Lechmere will redesign its existing audio software departments to take advantage of continued growth in sales of compact discs.

Lechmere Picks up Expansion Pace With '86 Atlanta Entry

Lechmere will open four 85,000 square foot stores in Atlanta in 1986, marking the company's first expansion outside its New England base. ■ The new stores, which are scheduled to begin operations in the fall, are part of a 13-store expansion program for the 1986-1988 period. ■ Lechmere also will open stores in three New England markets in 1986: Nashua, New Hampshire, Weymouth, Massachusetts and Hartford, Connecticut. ■ Total stores will number 17 at year-end.

Our objective is to provide our shareholders with a superior return on their investment through a combination of stock price appreciation and current income, while maintaining a flexible and conservative capital structure. The compound annual rate of return on Dayton Hudson stock has been 35% for the five years ended February 1, 1986, assuming that dividends were reinvested in Dayton Hudson stock.

Performance Objectives

Our financial performance objectives are designed to represent excellence among retail and other investment alternatives. They are reviewed periodically in light of changes in the competitive environment, equity investor opportunities or the rate of inflation. Because we take a long-term perspective when setting objectives, our actual performance in a given year may rank high compared with other companies, yet fall below our objectives.

Our current objectives are to:

- Earn an after-tax return on beginning shareholders' equity (ROE) of at least 18%. Our return on equity in 1985 was 16.3%, compared to 16.8% in 1984 and 18.2% in 1983.
- Sustain an annual growth in earnings per share (EPS) of at least 15%. EPS increased 9% in 1985, compared to 6% in 1984 and 18% in 1983. Over the past five years, earnings from retail operations have grown at a compound annual rate of 15%.
- Maintain a strong rating of our senior debt. Our long-term debt continues to carry the equivalent of a AA rating from Duff and Phelps, Moody's and Standard and Poor's. Our commercial paper is rated P-1 by Moody's and A-1 + by Standard and Poor's.

We believe that achievement of our financial performance objectives depends largely upon our ability to produce a superior return on investment (ROI). For example, return on equity results from the combination of ROI and leverage, as indicated in the following table:

We believe ROI is the most important single measure of financial performance and it is the primary financial tool we use to manage our business. We define ROI as the after-tax return on investment before financing costs. The following table shows the calculation of ROI for the past three years.

(Millions of Dollars)	1985	1984	1983
Net earnings	**$ 283.6**	$ 259.3	$ 245.5
Interest expense — after tax (a)	**49.9**	49.7	41.6
Interest equivalent in leases— after tax (b)	**23.3**	22.6	20.6
Earnings before financing costs	**$ 356.8**	$ 331.6	$ 307.7
Working capital (c)	**$ 983.1**	$ 877.2	$ 728.2
Property and equipment, net	**1,491.0**	1,370.6	1,199.2
Other non-current assets	**13.0**	14.7	12.4
Capital leases	**114.7**	115.8	97.9
Present value of operating leases	**359.8**	373.0	323.5
Total investment at beginning of year	**$2,961.6**	$2,751.3	$2,361.2
Return on investment	**12.0%**	12.1%	13.0%

(a) Interest expense on beginning-of-year debt and capital lease obligations
(b) Assumes after-tax interest cost of approximately 6% on beginning-of-year present value of operating leases.
(c) Current assets less non-interest bearing current liabilities

ROI is an important part of the following management processes:

Performance Appraisal. The incentive compensation of corporate management and the management of each operating company is based in part on return on investment, as well as on growth in earnings.

Capital Allocation. We allocate capital for expansion of an operating company based on its actual and projected performance measured against its ROI standard. Additional criteria for allocating capital include the quality of the company's strategic plan, strength of the management team, systems and development of market position.

			1985	1984	1983	Description of Ratios.
Return on Sales	=	Earnings / Sales	**4.1%**	4.2%	4.5%	Return on sales indicates the amount of profit per dollar of sales before financing costs.
times						
Investment Turnover	=	Sales / Investment	**2.9x**	2.9x	2.9x	Investment turnover provides a measure of the revenue generated from each dollar invested in our business.
equals						
Return on Investment	=	Earnings / Investment	**12.0%**	12.1%	13.0%	Return on investment provides a measure of profit generated from each dollar invested before financing costs.
times						
Leverage	=		**1.36x**	1.39x	1.40x	Leverage measures investment per dollar of equity capital, with an adjustment for interest expense.
equals						
Return on Equity	=	Net Earnings / Equity	**16.3%**	16.8%	18.2%	Return on equity provides a measure of profit generated per dollar of shareholder investment.

Investment and equity are beginning of period.

Capital Project Evaluation. All capital projects are expected to achieve ROI levels which will produce an internal rate of return over their life of 13%. The internal rate of return measure is designed to provide a profit on incremental investment above our cost of capital. We audit actual results in the years following completion to determine actual individual project performance.

Financial Policies

Consistent with our objective of maintaining a strong rating on our senior debt, we have established a maximum debt ratio of 45% of total capitalization, including capital leases and the present value of operating leases. Despite our expansion program, our debt ratio has been stable and below our policy maximum because of strong internal cash flow.

Capitalization (Millions of Dollars)	1985	1984	1983
Notes payable	$ —	$ —	$
Long-term debt (a)	814.2	631.1	630.4
Capital leases (a)	133.2	129.9	129.0
Present value of operating leases	392.8	359.8	373.0
Total debt and equivalent	1,340.2	1,120.8	1,132.4
Deferred items	129.1	104.3	78.7
Equity	1,947.4	1,736.5	1,540.2
Total capitalization	$3,416.7	$2,961.6	$2,751.3
Debt ratio (total debt and equivalent as a percentage of total capitalization)	39%	38%	41%

(a) Including current portion

The major portion of our growth will continue to be financed with internally generated funds. The remainder will be financed with a mix of intermediate-term and long-term debt which is consistent with the cash flow characteristics of our capital investments. Commercial paper will continue to be used primarily to fund seasonal working capital requirements.

Because of the lead times required for planning and construction of our stores, we make commitments for some of our capital projects before actual capital expenditures occur. Our financial policies limit the amount of these forward commitments to a level which could be funded internally.

Capital Investment

Target and Mervyn's continue to receive the majority of our capital investment allocation. Capital investment in 1985 totaled $487 million, including the present value of all new leases.

Capital Investment (Millions of Dollars)	1985	1984	1983
Capital expenditures	$422	$358	$335
Present value of new operating leases	65	39	42
Total	$487	$397	$377

Capital investment in 1986 is expected to total more than $600 million. For the 1986-1990 period, current plans anticipate capital investment of approximately $4 billion.

Dividends and Common Stock Price Per Share

In support of our goal of providing our shareholders with a superior return on their investment, it is our policy to make regular annual increases in dividends on common stock.

Dividends declared in 1985 totalled $.78½ per share, a 13% increase over the $.69½ per share declared in 1984. The quarterly dividend was increased to $.20½ per share for the dividend declared in the third quarter and $.21 per share for the dividend declared in the fourth quarter. The current annualized rate is $.84 per share.

Dayton Hudson Corporation common stock is listed on the New York Stock Exchange and the Pacific Stock Exchange with the symbol DH, and abbreviated in newspaper listings as DaytHd. At year-end, the number of Dayton Hudson shareholders of record was 15,022, compared with 15,898 at year-end 1984. On April 2, 1986, there were 15,012 shareholders of record and the common stock price was $50¼.

	Quarterly Dividend Declared Per Share		Common Stock Price Range			
Fiscal			1985		1984	
Quarter	1985	1984	High	Low	High	Low
First	$.18½	$.16¼	$40¾	$35¼	$32½	$27½
Second	.18½	.16¼	45¼	38	33¼	26⅛
Third	.20½	.18½	41¼	36½	37¼	31⅝
Fourth	.21	.18½	48¾	38⅞	37	29⅝
Total Year	$.78½	$.69½	$48¾	$35¼	$37¼	$26⅛

Analysis of Operations

(Thousands of Dollars, Except Per-Share Data)

Revenues increased 10% and earnings increased 9% in 1985. Our fiscal year included 52 weeks in 1985 and 53 weeks in 1984. On a comparable 52-week basis, the 1985 revenue increase was 11%. Increased sales due to expansion and sales growth within our base business were the major factors contributing to our 1985 revenue increase. Our performance follows a revenue increase of 15% and earnings growth of 6% in 1984.

In our ongoing effort to bring greater value to our customers, we continued our emphasis on competitive pricing strategies during 1985. These strategies, along with a promotional environment throughout much of 1985, resulted in a gross margin rate approximately equal to last year.

We use the last-in, first-out (LIFO) method of valuing inventories and determining cost of sales. Our 1985 LIFO provision was an expense of $.08 per share, compared with a credit of $.01 per share for 1984. This change resulted primarily from a higher inflation rate in 1985.

The following table illustrates the impact of the major factors in our earnings growth since 1982.

Consolidated Earnings Per Share Variance analysis:	1985 vs. 1984	1984 vs. 1983	1983 vs. 1982
Prior year's earnings per share	**$2.68**	$2.54	$2.15
Change in earnings per share due to:			
Revenues	**.32**	.43	.58
Gross margin rate	**—**	(.30)	(.22)
Operating expense rate	**.01**	.10	.30
Start-up expenses	**(.03)**	.04	(.05)
Interest expense, net	**(.01)**	(.06)	(.10)
Unusual expenses	**.09**	(.09)	—
Income tax rate	**—**	(.02)	.04
Corporate expense and other factors, net	**(.14)**	.04	(.16)
Earnings per share	**$2.92**	$2.68	$2.54

Revenues

Target, Mervyn's and our specialty merchandisers segment each reported double-digit increases in revenues for 1985. Department store revenues decreased 6%, reflecting the absence of revenues from Diamond's and John A. Brown following their sale in September 1984. If revenues from these companies are excluded from 1984 results, department store revenues increased 4% in 1985.

The major portion of our revenue growth was generated by Target and Mervyn's, primarily as a result of their aggressive expansion over the last few years. In addition to revenue growth from expansion, each of our business segments reported increases in comparable-store revenues (revenues from stores open longer than 12 months) during 1985.

Revenue Increases (Decrease)	1985 (52 weeks) All Stores	1985 (52 weeks) Comparable Stores	1984 (53 weeks) All Stores	1984 (53 weeks) Comparable Stores	1983 (52 weeks) All Stores	1983 (52 weeks) Comparable Stores
Target	**11%**	**6%**	14%	7%	29%	8%
Mervyn's	**18**	**8**	27	11	26	13
Department stores*	**(6)**	**4**	4	12	10	11
Specialty merchandisers	**15**	**6**	15	8	20	14
Total	**10%**	**6%**	15%	9%	23%	11%

*Results from Diamond's and John A. Brown included through September 29, 1984

One measure we use to evaluate the productivity of our stores is revenues per square foot. All four of our business segments again reported increases in 1985.

Revenues Per Square Foot* (Unaudited) (Dollars)	1985	1984	1983
Target	**$180**	$171	$162
Mervyn's	**$233**	$226	$214
Department stores**	**$184**	$177	$158
Specialty merchandisers	**$245**	$231	$211

*Thirteen-month average retail square feet

**Excluding revenues from Diamond's and John A. Brown

Our percentage of credit sales to total sales was 41% in 1985 and 1984, compared with 39% in 1983. Continued growth of third-party credit card sales throughout our companies in 1985 led to a slight increase in the portion of sales produced by these cards and an equivalent decrease in the portion of sales produced by internal credit cards. We recorded finance charge revenues of $144,065 on internal credit sales of $2,278,723 in 1985, $136,256 on sales of $2,186,890 in 1984 and $124,341 on sales of $1,902,572 in 1983. The provision for bad debts as a percentage of internal credit sales increased to 2.8% in 1985, compared with a favorable 1.8% in 1984 and 2.0% in 1983. The 1985 increase is due to higher losses resulting from initial market entries and a cautious outlook for potential losses on year-end receivables.

Gross Margin Rate

Our overall gross margin rate (which excludes buying and occupancy costs) was approximately equal to last year's rate due to the continuation of our competitive pricing strategy and the promotional environment during 1985. Target continues to expand its program of offering everyday low prices to its customers. B. Dalton introduced a promotional pricing program during 1985 which features discounts on popular titles in each of its stores. We continue to aggressively build sales volume, with a focus on generating strong increases in gross margin dollars, while at the same time emphasizing effective expense control.

Gross margin rates improved at Target and DHDSC and declined in the specialty merchandisers segment. Mervyn's gross margin rate was approximately equal to last year. The improvement at DHDSC followed a decline in department store gross margins during 1984. DHDSC margins were significantly better during the 1985 Christmas season. The specialty merchan-

disers' gross margin rate was impacted by a significant decline at B. Dalton due to its aggressive promotional program. Overall, our 1985 gross margins benefited from comparisons to weak margins in 1984. The 1984 gross margins were lower than in 1983 for all segments except Target. Margin declines at Target and Mervyn's in 1983 contributed to that year's lower overall rate.

Operating Expense Rate

Our operating expense rate improved slightly compared with the 1984 rate, continuing a trend of improvements in each of the last four years. This stems primarily from our continued emphasis on expense control. Better expense control at Target improved its operating expense rate in 1985. DHDSC's rate was approximately equal to last year. Mervyn's and the specialty merchandisers' rates increased. Operating expenses include buying and occupancy costs, selling, publicity and administrative expenses, depreciation, rent and taxes other than income taxes. They exclude start-up expenses.

Interest Expense

Our interest costs have risen as a result of higher levels of debt due to expansion and working capital requirements. We issued $300,000 of new long-term debt during 1985: $100,000 in the first quarter and $200,000 in the fourth quarter. Interest rates were lower on average in 1985 compared with 1984.

Interest costs incurred during the period of construction or remodeling are capitalized as part of an asset's cost. Our expense is reduced by this capitalized interest. Interest expense is reported net of interest income, which results from seasonal cash flows and from the temporary investment of proceeds from debt issues.

Components of Interest Expense, Net	1985	1984	1983
Interest cost incurred	**$95,410**	$88,771	$79,139
Interest cost capitalized	**(4,670)**	(4,260)	(3,287)
Interest expense	**90,740**	84,511	75,852
Interest income	**(7,448)**	(3,054)	(4,403)
Net expense	**$83,292**	$81,457	$71,449

Income Tax Rate

Our effective income tax rate was 45.9% in 1985 and 1984, and 45.5% in 1983. The 1983 rate was lower than the 1985 and 1984 rates because the investment tax credits, primarily due to Target and Mervyn's expansion, were a higher percentage of pretax earnings for that year. Our effective tax rates for 1985, 1984 and 1983 vary from the federal statutory rate as follows:

Percent of Earnings Before Income Taxes	1985	1984	1983
Statutory rate	**46.0%**	46.0%	46.0%
State income taxes, net of federal tax benefit	**3.9**	4.0	3.8
Tax credits, net*	**(3.8)**	(3.3)	(4.3)
Other	**(.2)**	(.8)	—
Effective tax rate	**45.9%**	45.9%	45.5%

*Net tax credits, primarily investment tax credits, were $19,706 in 1985, $15,871 in 1984 and $19,193 in 1983.

The components of the provision for income taxes for the last three years are:

	1985	1984	1983
Current:			
Federal	**$161,444**	$176,418	$138,116
State	**30,887**	34,038	26,236
	192,331	210,456	164,352
Deferred			
Federal	**41,226**	8,505	36,052
State	**7,397**	1,035	4,809
	48,623	9,540	40,861
Total	**$240,954**	$219,996	$205,213

We provide deferred income taxes for income and expenses which are recognized in different years for financial and tax reporting. Our deferred tax provision is comprised of the following timing differences:

	1985	1984	1983
Excess of tax over book depreciation	**$32,139**	$30,212	$26,822
Deferred income on installment sales	**14,380**	(4,715)	21,031
Capitalized interest	**(288)**	(1,078)	1,322
Write-down of assets	**(451)**	(9,595)	(4,190)
Lease capitalization	**(1,464)**	(1,340)	(1,375)
Other	**4,307**	(3,944)	(2,749)
Provision for deferred taxes	**$48,623**	$ 9,540	$40,861

Significant Events

▪ *Strategic Changes - Department Stores.* During 1984, strategic changes in our department store segment resulted in unusual expenses totaling $16,777 ($.09 per share). Dayton Hudson Department Store Company was formed by the combination of Dayton's and Hudson's effective May 1, 1984. Effective September 30, 1984, we sold substantially all the assets of Diamond's and John A. Brown to another retailer.

▪ *Sale of Plums.* In February 1984, we announced the end of our test strategy in off-price retailing, Plums, because the projected rate of return did not equal that of our established companies. The four store locations and most of the assets were sold to another retailer. The costs associated with Plums were included in 1983 earnings. The impact was insignificant.

Business Segment Comparisons (Millions of Dollars)	1985	1984	1983	1982	1981	1980
Revenues						
Target	**$3,931.5**	$3,550.1	$3,118 4	$2,412.4	$2,054.3	$1,531.7
Mervyn's	**2,527.0**	2,141.1	1,688.9	1,335.8	1,062.3	826.9
Department stores	**1,447.9**	1,547.8	1,483.9	1,350.2	1,285.5	1,203.9
Specialty merchandisers	**887.0**	770.0	672.1	562.3	540.8	471.0
Total	**$8,793.4**	$8,009.0	$6,963.3	$5,660.7	$4,942.9	$4,033.5
Operating profit						
Target	**$ 277.8**	$ 235.6	$ 176.8	$ 150.1	$ 108.7	$ 91.1
Mervyn's	**245.0**	223.3	184.5	152.3	119.6	76.3
Department stores	**121.8**	106.7	155.7	114.4	89.9	94.0
Specialty merchandisers	**37.0**	58.8	60.0	43.1	36.4	20.1
Total	**681.6**	624.4	577.0	459.9	354.6	281.5
Corporate expense	**57.2**	30.6	40.2	10.2	20.0	17.6
Interest expense, net	**83.3**	81.5	71.4	54.1	36.6	5.2
Interest expense on capital leases	**16.5**	16.2	14.7	10.8	10.5	8.4
Unusual expenses	**—**	16.8	—	—	—	—
Earnings before income taxes	**524.6**	479 3	450.7	384.8	287.5	250.3
Provision for income taxes	**241.0**	220.0	205.2	178.1	128.0	112.1
Net earnings:						
Continuing operations	**283.6**	259.3	245.5	206.7	159.5	138.2
Discontinued operations	**—**	—	—	—	13.9	8.5
Consolidated	**$ 283.6**	$ 259.3	$ 245.5	$ 206.7	$ 173.4	$ 146.7
Operating profit as a percent of revenues						
Target	**7.1%**	6.6%	5.7%	6.2%	5 3%	5.9%
Mervyn's	**9.7**	10.4	10.9	11.4	11.3	9.2
Department stores	**8.4**	6.9	10.5	8.5	7.0	7.8
Specialty merchandisers	**4.2**	7.6	8.9	7.7	6.7	4.3
Assets						
Target	**$1,518.8**	$1,374.9	$1,257.8	$1,056.2	$ 886.2	$ 708.4
Mervyn's	**1,614.5**	1,328.9	1,064.2	821.3	597.4	434.3
Department stores	**737.9**	727.2	863.3	819.5	787.7	734.1
Specialty merchandisers	**431.3**	348.7	291.1	241.8	204.5	224.8
Corporate and other	**115.0**	20.2	118.5	46.5	79.4	53.6
Total	**$4,417.5**	$3,799.9	$3,594.9	$2,985.3	$2,555.2	$2,155.2
Depreciation						
Target	**$ 70.0**	$ 65 7	$ 56.4	$ 42.1	$ 35.2	$ 21.8
Mervyn's	**54.5**	42.7	30.0	23.6	17.3	12.9
Department stores	**27.3**	31 9	33.0	31.2	29.8	25.0
Specialty merchandisers	**18.1**	14.7	12.0	10.4	9.5	7.6
Corporate and other	**1.9**	1.6	1.7	.7	.4	.4
	171.8	156.6	133.1	108.0	92.2	67.7
Less depreciation on capital leases	**8.0**	8.1	7.7	7.9	8.1	8.2
Total	**$ 163.8**	$ 148.5	$ 125.4	$ 100.1	$ 84.1	$ 59.5
Capital expenditures						
Target	**$ 138.3**	$ 109.8	$ 143.4	$ 137.5	$ 118.9	$ 125.7
Mervyn's	**176.6**	165.4	138.3	95.7	68.4	67.5
Department stores	**36.8**	33.5	26.5	27.8	46.5	51.8
Specialty merchandisers	**61.0**	44.2	19.6	18.6	18.7	20.0
Corporate and other	**9.2**	4.9	6.8	4.3	1.2	.2
	421.9	357 8	334.6	283 9	253.7	265.2
Less expenditures on capital leases	**7.9**	10.5	25.6	11.9	—	.4
Total	**$ 414.0**	$ 347.3	$ 309.0	$ 272.0	$ 253 7	$ 264.8

Department store results include Diamond's and John A Brown through September 29, 1984 Specialty merchandisers results include Dayton Hudson Jewelers through January 30, 1982

Business Segment Trends

The mix of our business operations continues to change. Target and Mervyn's are contributing a greater portion of our revenues and operating profit, while the percentage of the total contributed by our department store segment is declining. The business segment data on page 20 quantifies the shift into these high-growth strategies. The percentage of revenues generated by Target and Mervyn's has grown from 58% in 1980 to 73% in 1985. Operating profit generated by the two companies has increased from 59% in 1980 to 77% in 1985. In 1980, department stores generated 30% of total revenues and 33% of total operating profit, compared with 16% and 18%, respectively, in 1985.

The rapid expansion of Target and Mervyn's reflects our philosophy of allocating capital investment funds to the companies with the greatest potential for growth and return on investment. We anticipate continued growth from Target and Mervyn's. The majority of our capital investment dollars during the next five years will be allocated to these two companies. In 1985, 33% of our capital expenditures were made by Target and 43% were made by Mervyn's.

Quarterly Results (Unaudited)

Sales were strong throughout 1985, although the fourth-quarter comparisons suffered due to one less week in the fourth quarter of 1985. The greatest sales gains, compared with the prior year, occurred in the first quarter. Despite improving economic conditions, the retail environment remained competitive throughout the year, resulting in a continuing emphasis on promotions. The table below summarizes our results by quarter for 1985 and 1984.

We follow the same accounting policies in preparing our quarterly financial data as we do in preparing our annual data, with the following modifications:

- We expense costs of opening new stores throughout the year in which they are incurred.
- We recognize real estate taxes, bonuses, professional fees and benefit plan expenses throughout the year based on anticipated annual amounts.
- We accrue charitable contribution expense based on taxable income.
- We incur additional rental expense on the majority of our leased stores if the stores' annual sales exceed certain stipulated amounts. We estimate and record this additional rent each month based on actual monthly sales.
- We use our anticipated effective annual tax rate to compute income taxes on our quarterly earnings.
- During the year we forecast our annual LIFO expense based on estimates of three factors: inflation rates (based on the Department Stores Inventory Price Index published by the Bureau of Labor Statistics), inventory levels and initial mark-up levels. We allocate the projected expense to the quarters based on our historical experience of quarterly sales. In the fourth quarter of each year, we record an adjustment reflecting the difference between our estimates and actual LIFO expense. Our final 1985 LIFO provision was a charge of $.08. This was below our quarterly estimates due primarily to a lower than anticipated rate of inflation. Our final 1984 and 1983 LIFO expense amounts also were below our quarterly estimates due to changes in all three factors. The following table shows the LIFO impact on earnings per share as we reported it and as it would have been if we had known the final inflation rates, inventory levels and mark-up rates when we made our quarterly accruals.

LIFO Expense (Credit)	As Reported			Reallocated		
Quarter	**1985**	1984	1983	**1985**	1984	1983
First	**$ .06**	$ .06	$ .03	**$ .01**	$ —	$ .03
Second	**.03**	.02	.05	**.02**	—	.03
Third	**.05**	(.01)	.05	**.02**	—	.03
Fourth	**(.06)**	(.08)	—	**.03**	(.01)	.04
Total Year	**$ .08**	$ (.01)	$ .13	**$ .08**	$ (.01)	$ .13

(Millions of Dollars, Except Per Share Data)	First Quarter 1985	First Quarter 1984	Second Quarter 1985	Second Quarter 1984	Third Quarter 1985	Third Quarter 1984	Fourth Quarter 1985	Fourth Quarter 1984(b)	Total Year 1985	Total Year 1984(c)
Revenues	**$1,818.6**	$1,618.0	**$1,961.2**	$1,784.1	**$2,071.9**	$1,868.8	**$2,938.6**	$2,738.1	**$8,793.3**	$8,009.0
Gross Profit(a)	**$ 521.7**	$ 471.2	**$ 551.8**	$ 519.8	**$ 590.8**	$ 551.2	**$ 850.8**	$ 757.3	**$2,515.1**	$2,299.5
Net Earnings	**$ 33.4**	$ 28.4	**$ 40.0**	$ 39.4	**$ 56.9**	$ 43.2	**$ 153.3**	$ 148.6	**$ 283.6**	$ 259.3
Earnings Per Share	**$ .34**	$ .29	**$ .42**	$ .41	**$ .58**	$ .44	**$ 1.58**	$ 1.54	**$ 2.92**	$ 2.68

(a) Gross profit is revenues less cost of sales, buying and occupancy
(b) Consisted of 14 weeks
(c) Consisted of 53 weeks

Consolidated Results of Operations

Dayton Hudson Corporation and Subsidiaries

(Thousands of Dollars, Except Per-Share Data)	1985 52 Weeks Ended February 1, 1986	1984 53 Weeks Ended February 2, 1985	1983 52 Weeks Ended January 28, 1984
Revenues	**$8,793,372**	$8,009,030	$6,963,255
Costs and Expenses			
Cost of retail sales, buying and occupancy	**6,278,260**	5,709,483	4,924,887
Selling, publicity and administrative	**1,466,518**	1,310,042	1,160,472
Depreciation	**163,805**	148,453	125,471
Rental expense	**106,197**	102,904	96,593
Interest expense, net	**83,292**	81,457	71,449
Interest and depreciation on capital leases	**24,422**	24,333	22,406
Taxes other than income taxes	**146,304**	136,239	111,307
Unusual expenses	**—**	16,777	—
	8,268,798	7,529,688	6,512,585
Earnings Before Income Taxes	**524,574**	479,342	450,670
Provision for Income Taxes			
Current	**192,331**	210,456	164,352
Deferred	**48,623**	9,540	40,861
	240,954	219,996	205,213
Net Earnings	**$ 283,620**	$ 259,346	$ 245,457
Net Earnings Per Share	**$ 2.92**	$ 2.68	$ 2.54

These financial statements should be read in conjunction with information contained on pages 18-21 and 26-29

Consolidated Statements of Financial Position

Dayton Hudson Corporation and Subsidiaries

(Thousands of Dollars)	1985 February 1, 1986	1984 February 2, 1985
ASSETS		
Current Assets		
Cash	$ 91,801	$ 59,462
Marketable securities	96,422	2,500
Accounts receivable (net of allowance for doubtful accounts of $34,672 and $26,520)	1,060,129	995,967
Merchandise inventories (net of accumulated LIFO provision of $164,124 and $149,408)	1,272,175	1,103,922
Other	28,034	19,267
	2,548,561	2,181,118
Property and Equipment		
Land	235,437	194,705
Buildings and improvements	1,252,025	1,080,952
Fixtures and equipment	895,327	761,416
Construction-in-progress	99,459	74,213
Accumulated depreciation	(750,363)	(620,328)
	1,731,885	1,490,958
Property Under Capital Leases, Net	114,679	114,733
Other	22,389	13,041
	$4,417,514	$3,799,850
LIABILITIES AND SHAREHOLDERS' INVESTMENT		
Current Liabilities		
Accounts payable (including outstanding drafts of $154,819 and $126,727)	$ 734,415	$ 611,490
Accrued liabilities	375,983	322,541
Income taxes payable	109,213	104,302
Current deferred income taxes	174,067	159,679
Current portion of capital lease obligations and long-term debt	24,753	10,356
	1,418,431	1,208,368
Capital Lease Obligations	128,149	125,191
Long-Term Debt	794,514	625,442
Deferred Income Taxes and Other	129,065	104,341
Shareholders' Investment		
Common stock	97,196	96,992
Additional paid-in capital	12,748	9,490
Retained earnings	1,837,411	1,630,020
	1,947,355	1,736,502
	$4,417,514	$3,799,850

These financial statements should be read in conjunction with information contained on pages 18-21 and 26-29

Consolidated Statements of Changes in Financial Position

Dayton Hudson Corporation and Subsidiaries

(Thousands of Dollars)	1985	1984	1983
Funds Provided By Operations			
Net earnings	$ 283,620	$259,346	$245,457
Depreciation and amortization	172,836	157,004	133,753
Deferred income taxes	34,235	14,255	19,830
	490,691	430,605	399,040
Investment Activities and Distribution to Shareholders			
Expenditures for property and capital leases	421,936	357,759	334,547
Disposals of property and capital leases	(9,305)	(81,856)	(12,072)
Increase in working capital*	45,516	162,836	74,291
Dividends	76,229	67,369	60,425
	534,376	506,108	457,191
Net Financial Requirements	$ 43,685	$ 75,503	$ 58,151
Financing Activities			
(Increase) decrease in cash and marketable securities	$(126,261)	$ 56,959	$ (74,738)
Current maturities and retirements of long-term debt and capital lease obligations	(121,480)	(15,855)	(14,132)
Increase in capital lease obligations	7,905	10,482	25,606
Additions to long-term debt	300,000	6,948	106,426
Other, net	(16,479)	16,969	14,989
Net Financing Provided	$ 43,685	$ 75,503	$ 58,151
***Analysis of Changes in Working Capital:**			
Accounts receivable	$ 64,162	$ 41,127	$123,124
Merchandise inventories	168,253	105,211	213,762
Other current assets	8,767	(2,087)	6,504
Accounts payable	(122,925)	1,371	(163,232)
Accrued liabilities	(53,442)	9,616	(70,177)
Income taxes—payable and current deferred	(19,299)	7,598	(35,690)
Increase in Working Capital	$ 45,516	$162,836	$ 74,291

These financial statements should be read in conjunction with information contained on pages 18-21 and 26-29

Consolidated Statements of Shareholders' Investment

Dayton Hudson Corporation and Subsidiaries

(Thousands of Dollars)	Total	Common Stock	Additional Paid-In Capital	Retained Earnings
Balance January 29, 1983	$1,348,763	$48,238	$47,514	$1,253,011
Net earnings	245,457			245,457
Dividends declared	(60,425)			(60,425)
Stock option activity	6,384	240	6,144	
Two-for-one stock split	—	48,315	(48,315)	
Balance January 28, 1984	1,540,179	96,793	5,343	1,438,043
Net earnings	259,346			259,346
Dividends declared	(67,369)			(67,369)
Stock option activity	4,346	199	4,147	
Balance February 2, 1985	1,736,502	96,992	9,490	1,630,020
Net earnings	283,620			283,620
Dividends declared	(76,229)			(76,229)
Stock option activity	3,462	204	3,258	
Balance February 1, 1986	$1,947,355	$97,196	$12,748	$1,837,411

Preferred Stock
Authorized 200,000 shares, voting, without par value no shares outstanding at February 1, 1986, and February 2, 1985

Common Stock
Authorized 160,000,000 shares $1 par value, 97,196,263 shares issued and outstanding at February 1, 1986, 96,991,626 shares issued and outstanding at February 2, 1985

These financial statements should be read in conjunction with information contained on pages 18-21 and 26-29

Summary of Accounting Policies

Consolidation. Our financial statements include the accounts of Dayton Hudson Corporation and subsidiaries after elimination of material intercompany balances and transactions. All subsidiaries are wholly owned.

Marketable Securities. We record short-term investments at cost, which approximates market

Sales and Accounts Receivable. Our policy generally is to write off accounts receivable when any portion of the balance is 12 months past due, or when the required payments have not been received for six consecutive months. We base our allowance for doubtful accounts receivable on our past bad debt experience and on the ages of the various accounts.

All customer receivables are classified as current assets, including portions which are due after one year. This is consistent practice in the retail industry.

For financial reporting, we recognize the profit on retail installment sales when the sales are recorded. For income tax purposes, we use the installment method of reporting profit on these sales.

Inventories. Inventories and the related cost of sales are accounted for by the retail inventory method using the last-in, first-out (LIFO) basis.

Property and Equipment. Property and equipment is recorded at cost less accumulated depreciation. For financial reporting, we compute depreciation on our property using the straight-line method over estimated useful lives. For tax purposes, we use accelerated depreciation or the accelerated cost recovery system (ACRS).

Start-up Expenses. We recognize the costs of opening new stores and remodeling existing stores evenly throughout the year in which they are incurred, based on anticipated annual amounts

Investment Tax Credit. The investment tax credit reduces income taxes in the year we begin using the related property.

Per-Share Data. To compute consolidated net earnings per share we divide net earnings by the weighted average number of common shares outstanding. Performance shares and the exercise of stock options would not materially dilute earnings per share.

Fiscal Year. Our fiscal year ends on the Saturday nearest January 31:

Fiscal Year	Ended	Weeks
1985	February 1, 1986	52
1984	February 2, 1985	53
1983	January 28, 1984	52

Unless otherwise stated, references to years in this report relate to fiscal years rather than to calendar years.

Reclassification of Accounts. From 1978 through 1983, we reported the disposition of our real estate business as discontinued operations. Because virtually all of these assets had been sold and all related costs incurred, discontinued operations were combined with our retail business beginning in 1984. Various reclassifications were made in 1984 to the previously reported 1983 amounts to conform with the current presentation.

Debt and Leases

(Thousands of Dollars)

Lines of Credit

We had no commercial paper or short-term notes payable outstanding at February 1, 1986. During the year, the average amount of commercial paper outstanding was $54,373, at a weighted average interest rate of 8.0%. We maintained $68,500 of unsecured lines of credit with nine banks. Borrowings under these lines are at the prime interest rate or at other rates agreed upon at the time of the borrowings. We compensate the banks for the lines of credit through the payment of fees. During 1985, our line agreements required us to pay fees of $192. We were not required to maintain any compensating balances under any of the agreements during 1985.

At year-end, we also had additional credit available in the form of two annually renewable revolving-credit agreements: one for $185,000 with 11 lending institutions, and one for $65,000 with four lending institutions. We pay a fee for this availability and have the option of borrowing at the prime rate or other negotiated rates. During 1985, we paid fees of $649 under our revolving-credit agreements. Any balance outstanding under the agreements at the end of their term may be converted at our option into a four-year term loan. There were no balances outstanding at February 1, 1986.

We maintain additional unsecured bank lines of credit of $78,000 to meet seasonal working capital needs between September 15 and December 15 in each year.

Long-Term Debt

Long-term debt increased due to our issuance of $200,000 of sinking fund debentures and $100,000 of notes during 1985. We retired $100,000 of notes and repurchased $10,000 of sinking fund debentures during the year, as described below. At year-end, long-term debt due beyond one year was:

	Feb. 1, 1986	Feb 2, 1985
Sinking fund debentures:		
7¾% due 1994	$ 4,487	$ 4,587
9¾% due 1995	5,341	5,377
10⅞% due 2005	100,000	100,000
14¼% due 2012	75,800	100,000
11⅞% due 2012	100,000	100,000
10¾% due 2013	100,000	100,000
12% due 2015	100,000	
11¼% due 2015	100,000	—
	585,628	409,964
Sinking fund notes	41,800	45,000
Other unsecured notes—maturing at various dates to 2005 and bearing interest from 7¾% to 13¼%	138,998	139,468
Mortgage notes—notes and contracts for purchase of real estate, maturing at various dates to 2010 and bearing interest from 6½% to 14%	28,088	31,010
Total	$794,514	$625,442

The sinking fund and principal payments on this long-term debt over the next five years will be $19,711 in 1986, $5,921 in 1987, $10,953 in 1988, $10,997 in 1989 and $13,641 in 1990.

Sinking Fund Debentures. Annual sinking fund payments of $1,250 are required on both the 7¾% and 9¾% issues. The remaining issues have annual sinking fund requirements rang-

ng from $4,000 to $6,650, commencing at various dates from 1988 to 1996. During 1985, we repurchased $10,000 of the 14¾% debentures, which we may use to satisfy future sinking fund requirements. In addition, we have committed to repurchase an additional $14,200 of the 14¾% debentures in 1986. Accordingly, this amount is reflected as a current liability in our Statements of Financial Position.

Sinking Fund Notes. The balance at year-end represents borrowings under a private placement agreement at an interest rate of 8⅝%. Annual principal repayments of $3,200 continue through 1999.

Other Unsecured Notes. In November 1985, we issued $100,000 of 10⅝% notes due 1995. These notes are prepayable at a premium over par anytime after November 7, 1992. Also included in Other Unsecured Notes are several industrial development revenue bond issuances from 1980 through 1984 totaling $30,800 and maturing at various dates to 2005. Unsecured obligations of varying maturities make up the balance of this category.

In December 1985, we satisfied the future requirements of our 15¼% $100,000 notes due 1991 by depositing in an irrevocable trust an amount sufficient to meet the future principal and interest payments on the notes. The trustee has been instructed to redeem the notes on November 15, 1986, when they are prepayable at par. As a result of this in-substance defeasance transaction, the notes and trust assets have been removed from our balance sheet.

Subsequent Debt Issues. Subsequent to fiscal year end, we issued $100,000 of 7⅞% notes due 1996 and $100,000 of 9¼% debentures due 2006. We intend to use the proceeds for expansion. Portions of the proceeds may also be used to refinance certain long-term debt.

Covenants and Collateral. In most of our long-term debt agreements, as well as the revolving credit agreements, we have agreed to observe certain covenants at the request of the lenders. Among these are provisions related to working capital, funded debt, dividends and secured debt. Under the most restrictive of these provisions, $1,056,807 of our retained earnings at the end of 1985 was available for dividends and other types of restricted payments.

As a condition of borrowing under our mortgage notes and contracts, we have pledged related land, buildings and equipment as collateral. At year-end, approximately $35,600 of our property and equipment served as collateral for these loans.

Leases

For financial reporting, we classify leases as either operating or capital leases. Capital leases are recorded as assets on our Statements of Financial Position and we report interest and depreciation expense on the leases instead of rent expense. Operating leases are not capitalized and lease rentals are expensed. For tax purposes, we deduct rent expense on all leases.

Many of our longer-term leases include options to renew, with renewal terms varying from five to 30 years. Certain leases also include options to purchase the property. In addition, we have capital leases on equipment with remaining terms ranging from one to five years.

The detail of leased property and equipment which we have capitalized in our Statements of Financial Position is:

	Feb. 1, 1986	Feb. 2, 1985
Land and buildings	**$154,562**	$146,754
Equipment	**19,022**	19,182
Accumulated depreciation	**(58,905)**	(51,203)
Total	**$114,679**	$114,733

If we were to capitalize the minimum lease payments for all of our operating leases with initial terms of over one year, the present value of these payments would be approximately $392,791 at February 1, 1986, and $359,839 at February 2, 1985. These present values were calculated using an average interest rate for each lease based on the year of inception. The weighted average interest rate used to calculate the 1985 present value was 13%, compared with 12% for 1984.

The impact of recording depreciation and interest expense rather than rent expense on the capital leases has been to decrease our net earnings by $1,792 in 1985, $1,672 in 1984 and $1,501 in 1983. Capital lease depreciation expense was $7,953 in 1985, $8,144 in 1984 and $7,736 in 1983.

Many of our store leases entitle the lessor to receive additional rent if sales of the leased stores exceed certain stipulated amounts. The additional rents are referred to as percentage rents because they are usually based on a percentage of sales over stated levels. Real estate taxes, insurance and other executory costs may be included in our rental payment or charged in addition to rent. In either case, we have included these expenses in Occupancy Costs in our Results of Operations.

Composition of Rental Expense	1985	1984	1983
Minimum rents on long-term operating leases	**$ 77,378**	$ 71,311	$66,319
Short-term rentals	**9,944**	12,044	13,844
Percentage rents			
Operating leases	**20,299**	20,157	18,158
Capital leases	**1,250**	1,523	1,565
Sublease income	**(1,003)**	(527)	(1,828)
Executory costs	**(1,671)**	(1,604)	(1,465)
Net expense	**$106,197**	$102,904	$96,594

Future minimum lease payments which must be made under noncancellable lease agreements existing at the end of 1985 are:

	Operating Leases	Capital Leases
1986	$ 79,933	$ 22,043
1987	75,908	21,021
1988	72,334	19,805
1989	67,660	19,372
1990	63,845	19,328
After 1990	445,230	263,506
Total minimum lease payments (a)	$804,910	365,075
Less: Interest		219,437
Executory costs		12,447
Capitalized lease obligations, including current portion of $5,042		$133,191

(a) Minimum rental payments have not been reduced by minimum sublease rentals due in the future under noncancellable subleases ($6,750 for operating leases, $12,650 for capital leases).

(Thousands of Dollars, Except Per-Share Data)

Pension Plans

We have three defined benefit pension plans which cover all employees who meet certain requirements of age, length of service and hours worked per year. The benefits provided are based upon years of service and the employee's compensation during the last five years of employment.

Contributions to the pension plans, which are made solely by the Corporation, are determined by our outside actuarial firm. To compute net pension cost, our actuarial firm estimates the total benefits which will ultimately be paid to eligible employees and then allocates these costs to their service periods. Assumptions are made on the years the employees will work, their future salary increases, the number of employees who will earn the right to receive benefits under the plans, the rate at which to discount future pension benefits and the rate of return which will be earned on the plans' present assets and future contributions.

During 1985, we changed our method of accounting for pension costs to conform with the newly issued Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions." The change reduces our 1985 net pension cost by $13,385. Restatement of prior years is not permitted by the Statement.

The Statement requires employers with defined benefit pension plans to calculate pension costs using the unit credit actuarial method, which we adopted in 1983. Service cost under the unit credit method is computed by determining the increase in future pension benefits resulting from the current year's service and discounting these future cash flows to the present. Therefore, service cost will increase as employees age. The projected benefit obligation is the actuarial present value of all future benefit payments for services rendered to date, including an assumption as to future compensation levels.

The Statement also provides more guidance in the selection of the actuarial assumptions indicated in the following table. Previously, these assumptions were acceptable if, in the aggregate, pension results were reasonable. Now, each assumption is required to be analyzed individually and reviewed annually.

The period over which to amortize unrecognized pension costs and credits, including prior service costs (we have none) and actuarial gains and losses is based on the remaining service period for those employees expected to receive pension benefits. Actuarial gains and losses result when actual experience differs from that assumed or when actuarial assumptions are changed.

At January 1, 1985, our pension plans had an unrecognized net asset of $54,948. This transitional asset is not recorded on our balance sheet, but is being amortized to net pension cost over 6.9 years, which is the average remaining service period of our employees.

Post-Retirement Health Care Benefits

In addition to providing pension and other supplemental benefits, we provide certain health care benefits for our retired employees. Employees become eligible for these benefits if they meet minimum age and service requirements, are eligible for retirement benefits and agree to contribute a portion of the

Reconciliation of Funded Status to Accrued Pension Cost	Fair Market Value of Plan Assets(a)	Plus Projected Benefit Obligation	Plan Assets in Excess of Projected Benefit Obligation	Less: Unrecognized Net Actuarial Gains	Less: Unrecognized Transitional Asset	Accrued Pension Cost(f)
Balance January 1, 1985	$ 217,160	$ (174,786)(b)	$ 42,374	$ —	$ 54,948	$(12,574)
Net pension (cost) credit:						
Service cost		(8,641)				(8,641)
Interest cost		(16,605)				(16,605)
Assumed return on plan assets	20,630(g)					20,630
Amortization					(7,958)	7,958
Net pension credit						3,342(d)
Net actuarial gains	24,270(g)	518		24,788		—
Contributions	95					95(e)
Benefit payments	(15,204)	15,238				34
Balance December 31, 1985	**$246,951**	**$(184,276)(c)**	**$62,675**	**$24,788**	**$46,990**	**$ (9,103)**

(a) Plan assets consist of equity securities, fixed income securities and insurance contracts

(b) December 31, 1984, amounts are not the same as the January 1, 1985, balances due to the implementation of Statement No. 87 The December 31, 1984, projected benefit obligation was $217,283 with $185,379 in accumulated benefits of which $174,148 was vested.

(c) Includes $161,131 of accumulated benefits of which $152,941 is vested.

(d) Net pension cost for 1984 and 1983 was $7,364 and $11,155, respectively, compared with a net pension credit of $3,342 for 1985.

(e) The plans' 1984 contribution receivable of $95 was paid in 1985 No contributions were made in 1984 and 1983 contributions were $7,390 The plans' 1985 contribution receivable of $4,870 will be paid in 1986

(f) This liability is included in Deferred Income Taxes and Other in the Statements of Financial Position

(g) The actual return on plan assets was $44,900

(h) Actuarial assumptions:	1985	1984	1983
Discount rate	**9.5%**	7.5%	7.0%
Expected long-term rate of return on plan assets	**9.5%**	7.5%	7.0%
Average assumed rate of compensation increase	**6.9%**	6.7%	6.6%
Average amortization period	**6.9 yrs.**	10 yrs.	20 yrs.

cost. We have the right to modify these benefits The cost of providing these retiree health care benefits is recognized as expense when claims are paid. These costs approximated $1,700 and $1,600 for 1985 and 1984, respectively

Supplemental Retirement and Savings Plan (SRSP)
Employees who meet certain eligibility requirements (based primarily on age and length of employment) can join the SRSP. Under the terms of the Plan, we match 50% of all employee contributions, with a maximum match of 2½% of the employee's gross cash compensation. Employees can invest up to 15% of their current gross cash compensation in the Plan, with up to 10% invested on a before-tax basis at their option. Employees are partially vested with respect to the employer matching contributions after they have been in the Plan two years and are fully vested after six years. Employee contributions are always fully vested.

The Corporation contributed $9,048 to the Plan in calendar year 1985, $8,917 in calendar 1984 and $6,886 in calendar 1983.

Assets, Liabilities and Equity of SRSP	December 31, 1985	1984
Investments at market value:		
Dayton Hudson stock fund	$ 87,915	$ 57,393
Fixed income fund	103,393	73,310
Equity fund	56,607	49,485
Total assets	$247,915	$180,188
Funds payable for securities, plan withdrawals and expenses	$ 2,988	$ 3,292
Plan equity	244,927	176,896
Total liabilities and equity	$247,915	$180,188

Employee Stock Ownership Plan
We have an Employee Stock Ownership Plan to provide employees with an additional opportunity to own shares of our common stock. All contributions to the Plan are made by the Corporation. Cash contributions are used by the Plan's Trustee to purchase Dayton Hudson common stock. All eligible employees share equally in that year's contribution. The annual contributions are made based upon the applicable tax laws in effect for the year to which the contribution relates. We accrued a contribution of $3,937 for the plan year ended December 31, 1985. Our contribution accruals for the plan years ended December 31, 1984 and 1983 were $3,530 and $3,156, respectively. Our contributions are paid to the Plan the following year.

Assets and Equity of Employee Stock Ownership Plan	December 31, 1985	1984
Cash and cash equivalents	$ 240	$ 19
Dayton Hudson common stock at market value (cost 1985 $7,024, 1984 $4,443)	8,716	4,095
Contribution receivable	3,937	3,530
Total assets and equity	$12,893	$7,644

Stock Options and Performance Shares
We have two stock option plans for key employees. At present, no new grants can be made under either plan. Grants have included stock options, performance shares, or both. The options have included Incentive Stock Options, Non-Qualified Stock Options, or a combination of both. Twelve months after the grant date, 25% of any options granted become exercisable with another 25% after each succeeding 12 months. The options are cumulatively exercisable and expire no later than 10 years after the date of the grant The performance shares pay cash and stock if certain selected performance goals are met at the end of a four-year period

We record compensation expense on performance shares based on the current market price of our common stock and the extent to which the performance goals are being met We recorded expense of $1,401, $1,207 and $1,808 in 1985, 1984 and 1983, respectively. When employees exercise options, the total option price is credited to Common Stock and Additional Paid-in Capital, and no expense is incurred.

The number of shares of unissued common stock reserved for future grants under all the plans was 1,265,347 at the end of 1985 and 1,575,841 at the end of 1984.

Options and Performance Shares Outstanding	Options: Number of Shares	Options: Price Per Share	Options: Shares Exercisable	Performance Shares
1983				
Beginning of year	1,397,708	$ 1.99-$27.13	679,116	206,152
Granted	285,380	33.88 37.34		
Cancelled	(29,621)	9.97- 33.88		
Exercised	(348,642)	2.61- 17.44		
1984				
Beginning of year	1,304,825	1.99- 37.34	611,913	177,682
Granted	214,451	32.63- 36.13		
Cancelled	(83,015)	12.36- 36.44		
Exercised	(198,096)	1.99- 35.94		
1985				
Beginning of year	1,238,165	4.52- 37.34	689,192	134,109
Granted	340,761	39.94		
Cancelled	(34,121)	14.30- 39.94		
Exercised	(186,656)	4.52- 37.34		
End of year	1,358,149	$ 7.13-$39.94	698,955	100,714

Commitments and Contingencies
Commitments for the purchase of real estate, construction of new facilities and remodeling amounted to approximately $83,000 at February 1, 1986. We had additional commitments of approximately $50,000 for equipment purchases.

Our contingent liability for mortgage debt on certain office properties sold in 1976 and certain shopping centers sold in 1978 was approximately $40,000 at February 1, 1986. The purchasers have agreed to indemnify us for any costs we might incur in relation to the mortgages.

Our business brings us into regular contact with the general public, other businesses and governmental entities. This exposure subjects us to claims and litigation arising out of the ordinary course of business. Considering the insurance coverage in place for a portion of the claims and litigation, and noting that the ultimate consequences cannot be accurately predicted, management and legal counsel believe that presently identified claims and litigation will not have a material adverse effect on our operations or financial condition.

Auditors' Report

Report of Ernst & Whinney, Independent Auditors
Board of Directors and Shareholders
Dayton Hudson Corporation
Minneapolis, Minnesota

We have examined the consolidated statements of financial position of Dayton Hudson Corporation and subsidiaries as of February 1, 1986 and February 2, 1985, and the related consolidated statements of results of operations, changes in financial position and shareholders' investment for each of the three years in the period ended February 1, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Dayton Hudson Corporation and subsidiaries at February 1, 1986 and February 2, 1985, and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended February 1, 1986, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Whinney

Minneapolis, Minnesota
March 21, 1986

Report of Management

Responsibility for Financial Statements and Accounting Controls
The financial statements and other information presented in this report have been prepared in accordance with generally accepted accounting principles. Management is responsible for the consistency, integrity and presentation of the information in the Annual Report, which necessarily includes some amounts based upon our judgments and best estimates.

To discharge this responsibility, we maintain a comprehensive system of internal controls designed to provide reasonable assurance that assets are safeguarded and transactions are executed in accordance with established procedures. The concept of reasonable assurance is based upon a recognition that the cost of the controls should not exceed the benefit derived. After judging the cost and benefit factors, we believe our system of internal controls provides this reasonable assurance.

The Audit Committee of the Board of Directors, consisting of five outside directors, recommends independent auditors for appointment by the Board, and reviews their proposed services and their reports. The Committee also reviews the internal audit plan and their audit results. Our independent auditors, Ernst & Whinney, our internal auditors and our corporate controller have full and free access to the Audit Committee, and meet with it periodically, with and without the presence of management. The results of the auditors' examinations and their opinions on the adequacy of our internal controls and the quality of our financial reporting are regularly reviewed by the Committee.

Our financial statements have been examined by Ernst & Whinney, whose report appears on this page. Their report expresses an opinion as to the fair presentation of the financial statements and is based on an independent examination made in accordance with generally accepted auditing standards.

Kenneth A. Macke,
Chairman of the Board and
Chief Executive Officer

Gerald R. Gallagher,
Vice Chairman and Chief
Administrative Officer

Willard C. Shull, III,
Senior Vice President,
Finance

Susan S. Boren,
Vice President, Control

Inflation's Effect on Financial Reporting
Traditional financial statements prepared on a historical cost basis do not reflect inflation's impact on our financial performance or position. Historical measures tend to overstate earnings performance and understate the current cost to replace assets. While the rate of inflation has eased, the historical cost financial statements include the cumulative effects of both high and low inflation over the years. We believe, however, that inflation's impact on our financial statements is less than many companies due to the high percentage of our assets acquired during the recent inflationary periods, and the fact that the retail industry is less capital intensive than most other industries.

We have compensated for the effects of inflation in some aspects of our financial reporting. We use the last-in, first-out (LIFO) inventory accounting method for reporting purposes. We believe LIFO provides a better matching of current costs with revenues than does the first-in, first-out (FIFO) method. Consequently, our historical financial statements already provide in real terms a cost to replace the capital invested in inventories each year.

Our inflation-adjusted earnings include additional depreciation expense to reflect in real terms the cost of replacing our current store facilities. We have calculated this expense not only for capital leases, but for all operating leases as well.

- When we adjust our reported five-year revenue growth rate of 17% by the BLS index, our growth, excluding inflation's impact, is 14%—clearly a strong record.
- After adjusting our net earnings for the additional cost of maintaining owned and leased facilities, we continue to retain profits in our business on a real basis. We have done so for each year the data has been calculated.
- Our 1985 ROI, calculated on a current cost basis, is 7.7%, compared to 7.1% in 1984 and 7.3% in 1983. We continue to earn a strong ROI on an inflation-adjusted basis
- Shareholders' investment when adjusted for the current cost of our inventories and owned and capitalized leased assets, more accurately reflects the worth of our investment. The worth of our investment increases to $2.5 billion, compared with $1.9 billion as shown in our financial statements on page 23.

The inflation-adjusted data represent reasonable approximations of the price changes in our business during the periods under review. They do not represent specific measurements of the assets and expenses involved.

No adjustments to income tax expense were made in computing the inflation-adjusted information, in accordance with current accounting requirements.

Historical inventories, which are valued under the LIFO method, have been adjusted to approximate current replacement cost by adding back the cumulative LIFO provisions.

Adjustments for Inventories	LIFO Inventory	Accumulated LIFO Provision	FIFO Inventory
1985			
Target	**$ 549,804**	**$ 35,270**	**$ 585,074**
Mervyn's	**355,230**	**59,459**	**414,689**
Department stores	**174,752**	**48,862**	**223,614**
Specialty merchandisers	**192,389**	**20,533**	**212,922**
Total	**$1,272,175**	**$164,124**	**$1,436,299**
1984			
Target	$ 490,971	$ 33,767	$ 524,738
Mervyn's	270,026	47,474	317,500
Department stores	171,602	47,359	218,961
Specialty merchandisers	171,323	20,808	192,131
Total	$ 1,103,922	$ 149,408	$ 1,253,330

Adjustments for Owned and Leased Assets, Holding and Monetary Gains
Net property and equipment values are also higher because the costs to replace them are greater today than when they were purchased. Current costs of property and equipment were determined using indices based on annual changes in the cost of constructing or purchasing new assets. The adjustment for owned and leased assets is $590,049 at February 1, 1986, and $606,883 at February 2, 1985.

Holding and Monetary Gains
Holding gains occur when the worth of our assets as measured by the current cost method rises faster than the loss of purchasing power in the dollars needed to replace them, as measured by the CPI-U.

In 1985, the current cost of our inventories increased $14,716 and our property and equipment, including all leased assets, decreased $38,092 due to specific price rises. General inflation accounted for $156,600 of this change, resulting in a holding loss of $179,976.

Monetary assets, such as accounts receivable, lose purchasing power during an inflationary period because the dollars they represent purchase fewer goods and services upon realization. Monetary liabilities gain because less purchasing power is required to pay off the obligations.

Neither holding nor monetary gains are included in inflation-adjusted earnings.

The current cost information presented below is expressed in 1985 purchasing power as measured by the BLS (Bureau of Labor Statistics) and the CPI-U (Consumer Price Index - Urban) indices.

Management's Inflation-Adjusted Information (Millions of Dollars, Except Per-Share Data)	1985	1984	1983	1982	1981
Revenues (BLS)	**$8,793**	$8,132	$7,203	$6,014	$5,448
Earnings (CPI-U)	**$ 211**	$ 193	$ 186	$ 164	$ 126
Earnings Per Share (CPI-U)	**$ 2.18**	$ 2.00	$ 1.92	$ 1.71	$ 1.31
Shareholders' investment (net assets) (CPI-U)	**$2,517**	$2,389	$2,362	$2,169	$2,008
Dividends declared per common share	**$ .78**	$ .72	$ .68	$ .65	$ .61
Market price of common stock at year-end (CPI-U)	**$44.78**	$36.69	$31.64	$30.05	$16.52
Holding gains (losses) net of general inflation	**$ (180)**	$ (59)	$ 14	$ 23	$ 12
Net monetary gains	**$ 38**	$ 32	$ 33	$ 25	$ 47
Inflation indices					
Average CPI-U (1967 = 100)	**323.2**	312.1	299.4	290.0	274.2
Average of BLS rate (1973 = 100)	**165.2**	162.7	159.7	155.5	149.9

Financial Comparisons

Dayton Hudson Corporation and Subsidiaries

(Millions of Dollars, Except Per-Share Data)	1985	1984(a)	1983	1982
Revenues	$ 8,793.4	8,009.0	6,963.3	5,660.7
Cost of retail sales, buying and occupancy	$ 6,278.3	5,709.5	4,924.9	3,957.9
Selling, publicity and administrative	$ 1,466.5	1,310.0	1,160.5	971.8
Depreciation	$ 163.8	148.5	125.5	100.2
Interest expense (income), net	$ 83.3	81.5	71.4	54.1
Interest and depreciation on capital leases	$ 24.4	24.3	22.4	18.6
Earnings Before Income Taxes	$ 524.6	479.3	450.7	384.8
Income Taxes	$ 241.0	220.0	205.2	178.1
Net Earnings				
Continuing	$ 283.6	259.3	245.5	206.7
Discontinued	$ —	—	—	—
Consolidated	$ 283.6	259.3	245.5	206.7
Per Common Share				
Net earnings				
Continuing	$ 2.92	2.68	2.54	2.15
Discontinued	$ —	—	—	—
Consolidated	$ 2.92	2.68	2.54	2.15
Cash dividend declared	$ .785	.695	.625	.575
Shareholders' investment	$ 20.04	17.90	15.91	13.98
Return on Beginning Equity (Shareholders' Investment)				
Continuing	16.3%	16.8	18.2	17.3
Consolidated	16.3%	16.8	18.2	17.3
Capital Expenditures	$ 421.9	357.8	334.6	283.9
Consolidated Year-End Financial Position				
Working capital	$ 1,130.1	972.8	868.6	718.3
Property and equipment, net	$ 1,731.9	1,491.0	1,370.6	1,199.2
Property under capital leases, net	$ 114.7	114.7	115.8	97.9
Total assets	$ 4,417.5	3,799.9	3,594.9	2,985.3
Long-term capital lease obligations	$ 128.1	125.2	123.9	102.4
Long-term debt	$ 794.5	625.4	626.8	529.3
Shareholders' investment	$ 1,947.4	1,736.5	1,540.2	1,348.8
Average Common Shares Outstanding (Thousands)	97,068	96,892	96,601	96,220

The Financial Comparisons should be read in conjunction with the Financial Statements

Per-share amounts and shares outstanding reflect two-for-one common stock splits effective July 1983 and November 1981.

(a) Consisted of 53 weeks

1981	1980	1979	1978(a)	1977	1976	1975
4,942.9	4,033.5	3,384.8	2,961.9	2,494.7	2,125.8	1,852.2
3,482.0	2,844.1	2,353.4	2,055.4	1,731.6	1,480.1	1,285.2
883.8	734.3	626.6	539.5	441.5	377.8	336.6
84.1	59.5	43.7	34.4	31.2	26.8	24.2
36.6	5.2	(1.1)	8.2	9.9	8.9	9.0
18.5	16.6	13.4	12.0	10.4	8.7	7.8
287.5	250.3	240.7	198.9	187.2	153.9	126.3
128.0	112.1	114.2	101.3	95.5	79.4	65.6
159.5	138.2	126.5	97.6	91.7	74.5	60.7
13.9	8.5	65.6	167.3	6.2	2.5	(.1)
173.4	146.7	192.1	264.9	97.9	77.0	60.6
1.67	1.45	1.34	1.03	.98	.80	.66
.14	.09	.69	1.77	.06	.02	—
1.81	1.54	2.03	2.80	1.04	.82	.66
.525	.475	.425	.375	.325	.26	.18
12.41	11.14	10.09	8.50	6.10	5.28	4.63
15.0	14.4	15.6	16.8	18.4	17.1	16.0
16.3	15.2	23.8	45.7	19.6	17.7	16.0
253.7	265.2	218.2	156.1	104.9	76.1	33.4
508.9	381.3	438.8	427.6	309.4	288.2	266.2
1,031.7	872.2	629.8	472.2	379.7	317.2	280.0
93.9	100.4	67.2	70.9	57.0	52.2	46.7
2,555.2	2,155.2	1,793.2	1,637.5	1,411.4	1,213.1	1,083.2
96.3	103.3	73.0	76.8	62.0	56.6	50.6
331.8	213.8	117.6	94.3	116.8	111.7	123.8
1,192.7	1,066.4	962.6	808.4	579.8	499.2	435.9
95,788	95,212	94,764	94,388	94,000	93,300	91,788

TARGET	No. of Stores	Retail Sq. Ft. (000)
Arizona		
Phoenix	6	628
Tucson	2	216
Arkansas		
Little Rock	3	289
California		
Los Angeles	25	2,627
San Diego	7	757
Colorado		
Colorado Springs	2	229
Denver	11	1,135
Ft. Collins	1	100
Grand Junction	1	101
Greeley	1	83
Illinois		
Alton	1	100
Bloomington/Normal	1	101
Champaign	1	86
Danville	1	81
Fairview Heights	1	100
Moline	1	81
Mt. Carmel	1	58
Indiana		
Anderson	1	93
Bloomington	1	82
Carmel	1	81
Clarksville	1	86
Columbus	1	83
Crawfordsville	1	62
Evansville	2	184
Ft. Wayne	3	267
Huntington	1	60
Indianapolis	9	764
Kokomo	1	86
Lafayette	1	79
Muncie	1	84
New Albany	1	84
Richmond	1	78
Shelbyville	1	60
South Bend	3	262
Iowa		
Ames	1	68
Bettendorf	1	80
Cedar Rapids	2	181
Clinton	1	61
Des Moines	3	326
Dubuque	1	81
Ft. Dodge	1	67
Mason City	1	50
Ottumwa	1	52
Sioux City	1	100
Waterloo	1	101
Kansas		
Wichita	2	200
Kentucky		
Louisville	5	427
Louisiana		
Alexandria	1	101
Lafayette	1	101
Minnesota		
Duluth	1	125
Minneapolis/St. Paul	16	1,818
Rochester	1	101
St. Cloud	1	101
Missouri		
St. Louis	8	832
Montana		
Billings	1	101
Nebraska		
Lincoln	1	101
Omaha	3	305
North Dakota		
Bismarck	1	83
Fargo	1	100
Grand Forks	1	100
Minot	1	81
Ohio		
Middletown	1	79
Oklahoma		
Oklahoma City	5	495
Tulsa	2	207
South Dakota		
Rapid City	1	101
Sioux Falls	1	100
Tennessee		
Knoxville	2	182
Memphis	4	401
Nashville	3	303
Texas		
Abilene	1	101
Amarillo	1	101
Austin	2	202
Beaumont	1	101
Dallas/Ft. Worth	11	1,219
Denton	1	81
Houston	15	1,599
Lubbock	1	101
San Antonio	6	567
Tyler	1	81
Waco	1	101
Wichita Falls	1	100
Wisconsin		
Milwaukee	7	798
Racine	1	101
Wyoming		
Casper	1	81
Cheyenne	1	101
Total Target Stores	226	22,414

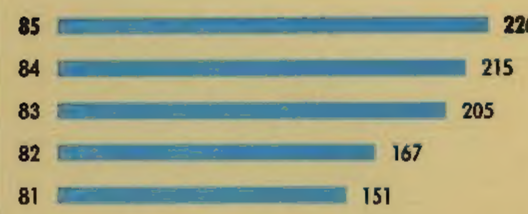
MERVYN'S	No. of Stores	Retail Sq. Ft. (000)
Arizona		
Chandler	1	75
Phoenix	6	512
Tucson	3	244
Yuma	1	76
California		
Bakersfield	1	102
Capitola	1	75
Chico	1	60
El Centro	1	64
Fresno	1	105
Lancaster	1	81
Lodi	1	68
Los Angeles	25	1,984
Marysville	1	67
Merced	1	65
Modesto	1	67
Monterey	1	83
Oceanside	1	75
Redding	1	61
Redlands	1	76
Riverside	1	77
Roseville	1	76
Sacramento	4	278
Salinas	1	60
San Bernadino	1	87
San Diego	6	490
San Francisco Bay Area	19	1,417
San Jose	6	501
San Luis Obispo	1	60
Santa Rosa	1	90
Stockton	1	81
Ventura	1	74
Visalia	1	60
Colorado		
Grand Junction	1	75
Louisiana		
New Orleans	2	169
Nevada		
Carson City	1	60
Las Vegas	2	159
Reno/Sparks	2	127
New Mexico		
Albuquerque	1	118
Santa Fe	1	62
Oregon		
Albany	1	61
Portland	3	279
Texas		
Amarillo	1	76
Austin	2	160
Dallas	8	673
Denton	1	63
El Paso	2	158
Ft. Worth	2	149
Houston	9	731
Lubbock	1	82
Odessa	1	76
San Antonio	3	245
Utah		
Ogden	1	83
Orem	1	93
Salt Lake City	4	354
Washington		
Seattle/Tacoma	2	224
Vancouver	1	83
Yakima	1	82
Total Mervyn's Stores	148	11,733

DAYTON HUDSON DEPARTMENT STORE COMPANY	No. of Stores	Retail Sq. Ft. (000)
Hudson's		
Detroit, MI	8	2,779
Ann Arbor, MI	1	187
Battle Creek, MI	1	103
Flint, MI	1	272
Grand Rapids, MI	1	124
Kalamazoo, MI	1	124
Lansing, MI	2	206
Pontiac, MI	1	289
Saginaw, MI	1	124
Ft. Wayne, IN	1	122
South Bend, IN	1	124
Toledo, OH	1	187
	20	4,641
Dayton's		
Minneapolis/St. Paul, MN		
Department Stores	7	2,316
Home Stores	3	183
Rochester, MN	1	163
St. Cloud, MN	1	99
Bismarck, ND	1	81
Fargo, ND	1	117
Grand Forks, ND	1	101
Sioux Falls, SD	1	102
La Crosse, WI	1	101
	17	3,263
Total Dayton Hudson Department Store Company	37	7,904

SPECIALTY MERCHANDISERS	No. of Stores	Retail Sq. Ft. (000)
B. Dalton Bookseller		
Northeast	126	481
Southeast	123	409
Midwest	235	744
South Central	116	367
Northwest	43	148
Southwest	140	522
Puerto Rico	2	6
	785	2,677
Lechmere		
Boston, MA	5	655
Springfield, MA	1	131
Manchester, NH	1	85
Albany, NY	1	104
Providence, RI	2	179
	10	1,154
Total Specialty Merchandisers	795	3,831
Total All Stores	1,206	45,882

Total Stores at Fiscal Year-End

TARGET



MERVYN'S

DAYTON HUDSON DEPARTMENT STORE COMPANY

SPECIALTY MERCHANDISERS

Totals for 1981 exclude Dayton Hudson Jewelers.

Directors

Rand V. Araskog,
Chairman of the Board and Chief Executive Officer, ITT Corporation (diversified multinational company) (1) (2) (3) (5)

Robert A. Burnett,
President and Chief Executive Officer, Meredith Corporation (media company engaged in printing, publishing, broadcasting and real estate) (1) (2) (3)

Gerald R. Gallagher,
Vice Chairman and Chief Administrative Officer

Roger L. Hale,
President and Chief Executive Officer, Tennant Company (industrial equipment manufacturer) (1) (3) (5)

Donald J. Hall,
Chairman of the Board, Hallmark Cards, Incorporated (greeting card manufacturer) (1) (2) (3)

Howard H. Kehrl,
Vice Chairman, General Motors Corporation (manufacturer of transportation equipment) (1) (3) (5)

Kenneth A. Macke,
Chairman of the Board and Chief Executive Officer (1)

Bruce K. MacLaury,
President, The Brookings Institution (research and education organization) (1) (4) (5)

David T. McLaughlin,
President, Dartmouth College (1) (4) (5)

John A. Rollwagen,
Chairman of the Board and Chief Executive Officer, Cray Research, Inc. (manufacturer of super computers) (1) (2) (4)

Boake A. Sells,
President

Shirley Young,
President, Grey Strategic Marketing, Inc. (subsidiary of Grey Advertising, Inc., national advertising agency) (1) (2) (4)

(1) Executive Committee
(2) Audit Committee
(3) Compensation Committee
(4) Corporate Responsibility Committee
(5) Finance Committee

Officers

Kenneth A. Macke,
Chairman of the Board and Chief Executive Officer

Boake A. Sells,
President

Gerald R. Gallagher,
Vice Chairman and Chief Administrative Officer

Bruce G. Allbright,
Senior Vice President

James T. Hale,
Senior Vice President and Secretary

John F. Kilmartin,
Senior Vice President

Willard C. Shull, III,
Senior Vice President

Edwin H. Wingate,
Senior Vice President

Ann H. Barkelew,
Vice President

David W. Beckley,
Vice President

Susan S. Boren,
Vice President

Larry E. Carlson,
Vice President

Peter Corcoran,
Vice President

Karol D. Emmerich,
Vice President and Treasurer

Thomas M. Etzkorn,
Vice President

L. Fred Hamacher,
Vice President

William E. Harder,
Vice President and Assistant Secretary

Peter C. Hutchinson,
Vice President

William P. Hise,
Assistant Secretary

Operating Company Management

Target

Bruce G. Allbright,
Chairman and Chief Executive Officer

Robert J. Ulrich,
President

Mervyn's

John F. Kilmartin,
Chairman and Chief Executive Officer

Walter T. Rossi,
President and Chief Operating Officer

Dayton Hudson Department Store Company

Stephen E. Watson,
Chairman and Chief Executive Officer

Raj Joneja,
President

B. Dalton Bookseller

Sherman A. Swenson,
Chairman and Chief Executive Officer

Thomas P. Bosch,
President and Chief Operating Officer

Lechmere

C. George Scala,
Chairman, President and Chief Executive Officer

Corporate Information

Corporate Offices
777 Nicollet Mall, Minneapolis, Minnesota 55402
Telephone: (612) 370-6948

Annual Meeting
The Annual Meeting of Shareholders is scheduled for 9:30 a.m. Wednesday, May 28, 1986, at The Children's Theatre, Minneapolis Institute of Arts, 2400 Third Avenue South, Minneapolis, Minnesota.

Community Involvement
In keeping with its commitment to corporate responsibility, Dayton Hudson annually contributes an amount equal to 5% of its federally taxable income to support its giving programs. For a complete report on 1985 contributions and programs, write to Vice President, Public Affairs.

10-K Report
A copy of the Form 10-K annual report filed with the Securities and Exchange Commission for Dayton Hudson's fiscal year ended February 1, 1986, is available at no charge to shareholders. Write to Director, Financial Relations, Dayton Hudson Corporation, 777 Nicollet Mall, Minneapolis, Minnesota 55402.

Dividend Reinvestment Plan
The dividend reinvestment plan is a convenient way for Dayton Hudson shareholders to acquire additional shares of the Corporation's common stock through automatic dividend reinvestment and voluntary cash purchase. All holders of Dayton Hudson common stock may participate. For more information, write to:
Morgan Guaranty Trust Company of New York
30 West Broadway, New York, New York 10015

Transfer Agent and Registrar
Morgan Guaranty Trust Company of New York

Dividend Agent
Morgan Guaranty Trust Company of New York

Trustees
First Trust Company, Inc.
First National Bank of St. Paul

Stock Exchange Listings
New York Stock Exchange
Pacific Stock Exchange
(Trading Symbol DH)

Shareholder Assistance
For assistance regarding individual stock records and transactions, contact:
Shareholder Relations
Dayton Hudson Corporation
777 Nicollet Mall, Minneapolis, Minnesota 55402

DAYTON HUDSON CORPORATION

777 Nicollet Mall

Minneapolis, Minnesota 55402